

BEFORE THE
POSTAL RATE COMMISSION
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POSTAL RATE COMMISSION
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POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

INITIAL BRIEF OF
ALLIANCE OF NONPROFIT MAILERS
AMERICAN BUSINESS MEDIA
COALITION OF RELIGIOUS PRESS ASSOCIATIONS
DOW JONES & COMPANY, INC.
MAGAZINE PUBLISHERS OF AMERICA, INC.
NATIONAL NEWSPAPER ASSOCIATION
THE MCGRAW-HILL COMPANIES, INC.
TIME WARNER, INC.

September 13, 2000

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I. INTRODUCTION

This has been an unusual case for Periodicals Mailers,¹ large and small alike. We were truly shocked when the United States Postal Service initially proposed Periodicals increases in the range of 14-16 percent, and in some cases in excess of 20 percent, particularly because Postal Service management had indicated only a few months before the case was filed that the average increase for Periodicals would be much less as a result of cost savings initiatives identified by the joint industry/Postal Service Periodicals Operations Review Team (Team).² After the case was filed, Postmaster General William J. Henderson acknowledged these expected savings. Tr. 24/11279, fn. 1. But, for some inexplicable reason, the Postal Service's initial filing did not reflect them.

As a result, the initially proposed Periodicals average increase was more than twice the average increase proposed for all types of mail, more than three times the increase in the CPI since the last rate increase, and more than twice what Periodicals Mailers believe is necessary or appropriate under the Postal Reorganization Act of 1970 (the Act). 39 U.S.C. 101, *et. seq.* The proposed increases would raise postage costs for users of the Periodicals class by more than \$300 million annually.

The increases, according to the Postal Service, were required by rapidly increasing Periodicals costs, particularly in the area of mail processing. Fortunately, Periodicals Mailers were not alone in their concerns about the alleged cost increases. On March 28, 2000, the Postal Rate Commission requested "that the Postal Service

¹ "Periodicals Mailers" refers to the parties sponsoring this brief.

² The Team's findings and recommendations are set forth in the Report of the Periodicals Operations Review Team, USPS-LR-I-193 (Team Report). Witness O'Brien discusses them in detail. Tr. 24/11166-95.

present detailed evidence explaining the causes of the trend in the costs of processing Periodicals.” PRC Order No. 1289 (March 28, 2000) at 1. The Order graphically displayed the rapid increase in Periodicals costs since 1993. Tr. 24/11267-68.³

Painstakingly, evidence has been introduced that establishes that substantial cost savings and reductions will be achieved by the Test Year. Postal Service witness Degen acknowledged that the record supports more than \$200 million in costs savings and reductions. Tr. 38/17329. Testimony presented by Periodicals Mailers witnesses and others established substantial additional savings and reductions for Periodicals that should be achieved by the Test Year. These savings and reductions are unrefuted and uncontested on the record. Postal Service witness Taufique testified that the Postal Service will now support a recommended increase for Periodicals that, on average, does not exceed single digits. Tr. 43/18776. As explained below, the record in this proceeding amply supports a recommended average increase for Periodicals that is no greater than the system-wide average increase. This is the result we urge the Commission to recommend. See Tr. 24/11296; Periodical Mailers Trial Brief at 29.

II. SUMMARY OF ARGUMENT

Given the length of this brief, Periodicals Mailers will refrain from presenting a summary of each of the issues it addresses but will instead offer more of a road map to aid the Commission as it seeks to create order from the chaos of an extraordinarily complicated record.

Our brief begins with a discussion of the various cost reductions with which the Postal Service and the Periodicals Mailers agree in all respects. We demonstrate that

³ Indeed, as long ago as 1992, the Commission initiated an inquiry into unexplained rapid increases in mail processing costs. The inquiry ended as a result of the Postal Service's lack of cooperation. PRC Order No. 1002 (January 14, 1994) at 4.

the Periodicals revenue requirement should be reduced to reflect cost savings from: (1) the new Line of Travel requirement recently enacted, (2) the new requirement for adherence to L001 labeling, (3) the elimination of carrier route skin sacks, (4) the combining of barcoded and non-barcoded bundles in the same sack, (5) the Memorandum of Understanding that addresses vertical flats casing, (6) reduced air transportation for Periodicals, and (7) breakthrough productivity in highway transportation.

We next demonstrate that other cost-savings initiatives will take place and will produce savings greater than those forecast by the Postal Service. These include reduced bundle breakage and automation savings resulting from deployment of the AFSM 100s. We also demonstrate that Periodicals costs should be reduced by (1) elimination of the AMTRAK premium, (2) reductions in supervisory costs and (3) "final adjustments" to reconcile Test Year costs with Test Year revenues.

Following these discussions of cost savings, Periodicals Mailers delve into the always complex issues of cost attribution and distribution. We show that the Commission should stick with its Docket No. R97-1 approach to the distribution of allied mixed mail costs, which distributes these costs broadly over the combined direct costs in all MODS cost pools. As proposed by the Postal Service, this approach should be extended to allied not handling costs. In doing so, the Commission should make use of, rather than discard, relevant data such as that obtained in response to IOCS questions 18 and 19.

Next, Periodicals Mailers demonstrate that, as acknowledged by the Postal Service, the costs attributed to Periodicals should be reduced to reflect the use of

annual (rather than four-week) RCCS data to distribute rural carrier costs to the subclasses.

Relying for the most part on the separate joint brief (of Advo, et al.), in which Periodicals Mailers have joined, we show that the Commission should reject the Postal Service's Engineering Standards study as a basis for attributing carrier costs but that, if it does use that study, it must also use the corresponding volume variabilities developed from the same data. Similarly, the Commission should accept the uncontradicted testimony that estimates a zero variability for drive time associated with routine loops and dismounts.

It should also use new variability estimates for highway transportation that, unlike those originally proposed by the Postal Service, are consistent with operating practices and do not overstate variability. And it should adopt both a new distribution key for Roadrainers service, now agreed to by the Postal Service, to reflect that Roadrainers carry a lower percentage of Periodicals than conventional AMTRAK and the redistribution of rail empty equipment costs, which was also accepted by the Postal Service.

Periodical Mailers next develop both factual and legal arguments in support of the Postal Service's mail processing variabilities. Although we cannot help but recognize the Commission's prior determinations on these complex issues, we submit that evidence in this record proves that these variabilities are significantly less than 100%, that there is no substantial and reliable evidence to support the hoary assumption of 100% variability, and that the Commission should not continue to use that assumption in the face of overwhelming evidence to the contrary.

We turn next to several additional revenue requirement issues, showing that the Periodicals Test Year revenues should be increased to reflect the “ride-along” revenues omitted from the Postal Service filing; that the systemwide contingency should be reduced substantially as shown in a separate brief of DMA, et al., joined in by Periodicals Mailers, but that the unique circumstances of this case justify a zero contingency for Periodicals; and that, consistent with the Commission’s most recent decisions and the Postal Service’s filing, the cost coverage for Periodicals should be held at a very low level.

Periodicals Mailers conclude this brief with a rate design section. There we show that the corrections to the USPS mail flow model and the USPS cost avoidance model made by Periodicals Mailers witnesses should be adopted, thus increasing automation, presort and DDU discounts. We also demonstrate that the Commission should recommend the unopposed proposal for a modest discount for Periodicals pieces on 5-digit pallets entered at the destination SCF or DDU and the greater than 100% passthroughs of automation-related cost avoidances proposed by the Postal Service.

III. THE POSTAL SERVICE’S REVENUE REQUIREMENT FOR PERIODICALS IS OVERSTATED

Periodicals Mailers will show below that the Postal Service’s claimed revenue requirement for Periodicals should be reduced substantially to reflect cost savings that it now agrees will occur, additional cost savings beyond those to which the Postal Service has agreed, and cost redistributions.

A. The Commission Should Accept the Estimates of Savings From Cost Reduction Efforts and "Final Adjustments" That Will Reduce Periodicals Test Year Costs Substantially

In this section we discuss cost savings that will be achieved in the Test Year and "final adjustments" that should be made to Test Year Periodicals costs.

In our Trial Brief, we said we would show the following:

- Joint industry/Postal Service efforts to reduce costs have identified initiatives that will reduce Test Year 2001 costs by more than \$150 million.
- Substantial identified Test Year savings confirmed by the Postal Service and established on the Docket No. R2000-1 record.
- Other efforts related to bundle breakage mitigation, AFSM 100 deployment, transportation, and additional initiatives will result in additional Test Year savings for Periodicals.

We have.

The record in this proceeding confirms each of these assertions. Further, Postal Service rebuttal witness Degen acknowledges substantial Test Year 2001 cost savings and indicates the Postal Service supports "a \$203 million downward adjustment in Periodicals costs that had been identified on the record." Tr. 38/17329. And, he testifies that this reduction is warranted whether FY 1998 or FY 1999 data are used as the base year. *Id.* Postal Service witness Taufique testifies that the Periodicals cost savings identified on this record permit a much smaller overall increase for Periodicals than originally proposed by the Postal Service and that the Postal Service would support a recommended increase for Periodicals that, on average, does not exceed "single digits." Tr. 43/18776.

1. Agreed Upon Test Year Cost Savings Established on the Record Total \$130 million

The record supports, *without contradiction*, the following Test Year 2001 cost reductions for Periodicals, which total \$130 million.

a. Preparation of basic rate carrier route Periodicals mail in Line of Travel sequence will result in savings of \$23 million in the Test Year

As witness Cohen explains, since 1997, the Postal Service has required Standard (A) Carrier Route flats to be prepared in Line of Travel (LOT) sequence. Tr. 24/11274-75. This same sequencing has not been required for Periodicals. As part of the Periodicals Mailers cooperative effort to identify mail preparation changes that could drive costs from the postal system, the Postal Service asked industry to consider a LOT requirement for Periodicals. Industry discussions revealed widespread willingness to prepare Periodicals in this manner, if it would reduce postal costs. As a result, the Postal Service undertook to quantify the potential savings from a LOT requirement for Periodicals. Finding substantial savings, the Postal Service has moved forward quickly.

As explained by Cohen, the Postal Service imposed "a line-of-travel (LOT) requirement for Periodicals Carrier Route Basic mail through a Federal Register notice." Tr. 24/11274, citing Tr. 21/8947. Just as it did for Standard (A) Carrier Route Basic flats, the LOT requirement will improve casing efficiency and reduce carrier costs for Periodicals. The Postal Service estimated that implementing the LOT requirement would reduce Periodicals costs by \$23 million in the Test Year. USPS-LR-I-307 at 8. Postal Service rebuttal witness Degen confirms these savings (Tr. 38/17220), and they are uncontradicted on the record.

- b. Changes in other Periodicals mail preparation requirements involving (a) mandatory compliance with the L001 option, (b) elimination of carrier route skin sacks, and (c) allowing barcoded and non-barcoded bundles in the same sack will yield Test Year savings of \$15 million**

Beginning February 29, 2000 and continuing into the summer, the Postal Service issued *Federal Register* notices that will require changes in the makeup of containers at the 5-digit level to maximize efficiency and to direct the mail to the point at which it will actually be processed. These changes will decrease the number of containers, particularly sacks. There are three components that lead to the reduction in containers: (1) mailers will combine mail for 5-digit zip codes that are processed together in an L001 sort scheme, (2) mailers will combine mail for carriers that deliver out of the same carrier delivery unit, and (3) mailers will combine barcoded and non-barcoded packages when this mail is processed together in incoming secondary operations. See 65 *Fed. Reg.* 10735-59 (February 29, 2000); 65 *Fed. Reg.* 16859-64 (March 30, 2000); 65 *Fed. Reg.* 50053-89 (August 16, 2000).

We support allowing mailers to combine mail and reduce the number of containers when doing so is consistent with Postal Service processes. This is reflected in two Team Report recommendations: (1) to match mail preparation to postal processing and (2) to optimize use of containers. In response, the Postal Service will require the use of the L001 scheme and the combining of CRRT "skin sacks" into "carrier routes" sacks. Postal Service rebuttal witness Degen acknowledges that these improved mail preparation standards will reduce Test Year After Rates (TYAR) costs for Periodicals by \$15 million. Tr. 38/17330, citing Tr. 46-D/21512-14; USPS-LR-I-332. These savings are uncontradicted on the record.

- c. **A work methods change embodied in a Memorandum of Understanding with the National Association of Letter Carriers will result in savings of \$7 million in the test year**

In the "Current Improvement Efforts" section of his testimony, witness O'Tormey describes a Memorandum of Understanding between the Postal Service and the National Association of Letter Carriers (NALC) that "gives management the authority to implement the vertical flats casing method for those routes not currently using it. Under this method, flats are sequenced in the order of delivery in one handling by the carrier rather than in two handlings." USPS-ST-42 at 24. Postal Service rebuttal witness Degen acknowledges that this processing change will result in Test Year savings of \$7 million for Periodicals. Tr. 38/17331, citing Tr. 46-C/20958. These savings are uncontradicted on the record.

- d. **Various mail processing enhancements involving (a) increased flat sorting productivity, (b) better AFSM 100 performance, and (c) addition of OCRs and automatic feeders to the FSM 1000 will result in Test Year cost savings of more than \$47 million**

The Team Report noted that the Postal Service should "look for low-cost opportunities to increase automated FSM capacity, e.g., more Barcoding and OCR capabilities on FSM machines." Team Report at 32. The Postal Service is following through on this recommendation by modifying FSM 1000s with OCRs and automatic feeders. Tr 46-D/21520. The Postal Service is also improving its capability to process flats in an automated fashion through the deployment of AFSM 100s. While it is too early to tell whether AFSM 100s will do for flats what barcode sorters have done for letters, early indications are extremely encouraging. Based upon pre-production improvements, the Postal Service acknowledges that it now believes that the performance of the AFSM 100s will be even better than expected. Tr. 46-D/21510.

The FSM 1000 modifications and the better-than-first-expected performance of the AFSM 100s will reduce Test Year costs for Periodicals by significantly more than was projected by USPS witness Tayman (USPS-T-9). In fact, the Postal Service now projects that savings for Periodicals from new equipment deployments and efforts to increase manual flat sorting and FSM productivity will be \$47 million more than the Service included in its original filing. Tr. 46-C/20872-75.⁴ These savings are uncontradicted on the record.

e. Reduced use of air transportation for Periodicals will result in savings of \$11 million in the Test Year

As witness Cohen discussed in her direct testimony, the Postal Service reduced its air transportation costs for Periodicals dramatically between FY 1998 and FY 1999 through "a concerted effort to keep 'surface mail off of air transport.'" As a result of this effort, the FY 1999 purchased transportation costs for Periodicals were \$11 million less than projected by the Postal Service in its original filing. Tr. 24/11277. Furthermore, the Postal Service testified that it believes that it can "[sustain] these reductions" into the Test Year. Tr. 46-C/20956-57. Therefore, should the Commission choose to use FY 1998 as the base year, it should include a cost reduction program in FY 1999 that reduces Test Year Periodicals transportation costs by \$11 million. Because these savings are already included in FY 1999 actual costs, the Commission would not have to make such an adjustment if it uses FY 1999 as the base year.

⁴ Witness O'Tormey included \$6 million for these improvement efforts. Tr. 46-D/21519-20; Tr. 46-C/20962. Degen also acknowledged the \$6 million. Tr. 38/17330. Witness Degen should have included the \$47 million projected by USPS in its most recent update in July.

f. Breakthrough productivity in highway transportation will result in savings of \$12 million in the Test Year

In his direct testimony, witness Nelson explained that the Postal Service could reduce its purchased highway transportation costs by ensuring that it receives competitive rates on renewed contracts⁵ and by eliminating unneeded routes before the end of contracts. He estimated that these initiatives would reduce Test Year Periodicals costs by \$6 million (see, e.g., Tr. 28/13416-18). It appears, perhaps not coincidentally, that the Postal Service has now determined that its breakthrough productivity initiatives will reduce highway transportation costs in the Test Year by even more than estimated by Nelson.

Indeed, as Postal Service witness Young recently testified, the Service is conducting a "systematic review" of three components of transportation costs – "the fuel, the trailers . . . and the contracts [for transportation of the mail] themselves" – with the achievable goal of reaching \$100 million in savings during the Test Year. Of this, \$12 million would be for Periodicals.⁶ See generally Response of Postal Service to POIR 14 at Attachment I (estimating that Highway Transportation Initiative, Trailer Leasing Management Program, and Fuel Management Program will reduce Test Year costs by \$100 million). These savings are uncontradicted on the record.

⁵ While USPS argued with Nelson about the magnitude of the "renewal premium," the record establishes that "renewal" contracts with highway transportation providers cost far more than do "non-renewal" contracts. See, e.g., Tr. 43/18543 (testimony of witness Bradley) ("on average, for most accounts," it is true that "renewal contracts for highway transportation . . . have rates higher than non-renewal contracts"); Tr. 43/18544-5 (testimony of witness Bradley); Tr. 43/18527 (testimony of witness Pickett) (non-renewal contracts are "significantly less expensive . . . than renew[al] contracts"); Tr. 43/18547.

⁶ Calculated by multiplying the Test Year Periodicals proportion of highway transportation costs by this \$100 million in savings. USPS-T-14, Exhibit USPS-14K at 43-44.

2. Additional Test Year Cost Savings Exceed Those Acknowledged by the Postal Service and Total at Least \$179 Million

The Postal Service has acknowledged cost savings in addition to those addressed above that will accrue in Test Year 2001, but the Periodicals Mailers have established that the savings acknowledged by the Postal Service are understated. The total of these additional savings as adjusted by Periodicals Mailers is \$179 million, or \$49 million more than recognized by USPS.

a. Efforts to reduce bundle breakage will result in Test Year cost savings of \$21 million

Postal Service witness Degen acknowledges that efforts to reduce bundle breakage will result in savings of at least \$15 million in the Test Year. Tr. 38/17330, citing Tr. 46-D/21521. Witness Cohen points out that witnesses Stralberg (TW-T-1) and Glick (MPA-T-2) demonstrate that these efforts will result in \$21 million in cost savings, rather than the \$15 million acknowledged by witness Degen. Tr. 24/11275-11276.

In its report, the Periodicals Operations Review Team noted that bundle breakage is a significant problem, but one that can be addressed:

Flats bundles are at risk of breaking during bundle sorting, especially when dumped on the automated feed systems of SPBS machines. Bundles that travel in sacks also incur substantial breakage during sack handling operations, although the sack preserves the presort level of the sack itself. There are a number of possible remedies that together could lead to substantial cost reductions, including better bundle strapping, use of pallets rather than sacks, improved bundle sorting methods, alternatives to today's SPBS feed systems, and better efforts at salvaging partially broken bundles.

Team Report at 24.

Since the issuance of the Team Report, Periodicals Mailers have worked actively with the Postal Service to determine the causes of bundle breakage and to reduce the problem. As explained by witness Glick, who is a member of the MTAC Package Integrity Work Group, through improved mailer preparation and USPS operations, the magnitude of this problem will be reduced significantly. Tr. 24/11227-35. The Postal Service agrees. Tr. 21/8169. Based upon the cost model presented by witness Yacobucci (USPS-T-25), the Postal Service estimates a \$15 million dollar reduction in Periodicals costs due to a 25 percent reduction in broken bundles. Tr. 46-D/21521.

Witness Cohen argues that the estimated 25 percent reduction significantly understates the reduction in bundle breakage that will be achieved in the Test Year. Tr. 24/11275-76. As described by witness Glick, efforts to reduce bundle breakage are proceeding on many fronts simultaneously and with a not surprising sense of urgency. Witness Cohen points to:

changes in bundle preparation already being taken by publishers and their printers based on reports emerging from the MTAC Work Group that bundles enclosed in polywrap have lower breakage rates. Publishers have a very strong interest in retaining bundle integrity, not only to keep costs down, but also because bundle breakage tends to damage the magazines in the bundle. Damaged subscriber copies are something the magazine industry tries to avoid assiduously.

Tr. 24/11276.

With the significant effort being put forth by industry, USPS, MTAC, and printers, Periodicals Mailers believe a 50 percent reduction in bundle breakage is easily achievable. Tr. 24/11235 (Glick), Tr. 24/11276 (Cohen). Correcting for witness Yacobucci's inappropriate averaging of bundle breakage rates for sacks and pallets,

witness Glick shows that industry and Postal Service efforts to reduce bundle breakage and improve bundle recovery methods will reduce Periodicals costs by \$21 million in the Test Year. Tr. 24/11235-36, 11276.

b. Corrections to the projected cost savings from the AFSM 100 Total \$24 million

The separate brief of DMA, *at al.*, in which Periodicals Mailers have joined, demonstrates that the Postal Service has understated the savings forecast from deployment of the AFSM 100s. As explained more fully there, witness Buc, using data provided by Postal Service witnesses, showed that Postal Service witness Tayman understated the Test Year cost savings that will be achieved from procurement and introduction of the AFSM 100. See Tr. 22/9956; see also Tr. 28/17149-50 (statement that Buc correctly reflected the Postal Service's projected savings). In response to PRC Order No. 1294, May 26, 2000, the Postal Service updated and increased the Test Year cost savings it anticipates from the AFSMs. Tr. 38/17076. In supplemental testimony, witness Buc again conclusively demonstrated that the Postal Service's cost savings estimates are nevertheless still understated. Witness Cohen, using witness Buc's updated estimates of AFSM 100 savings, established that the portion of such savings allocable to Periodicals will be \$24 million more than acknowledged by the Postal Service. Tr. 24/11277.

c. By Eliminating the AMTRAK Premium, the Postal Service can Reduce Periodicals' Costs by \$15 Million

MPA witness Nelson testified that the Postal Service pays a substantial premium for rail transportation services and that it could easily eliminate this premium by the Test Year. Tr. 28/13418-13421. Nelson found that the Postal service pays a 30 percent

premium on its Amtrak contracts "without discernible benefit." Tr. 28/13419. He calculated this premium by comparing Amtrak costs to those for comparable highway transportation, concluding that "[i]f the Postal Service replaced this Amtrak service with new contract highway service procured at the rates it paid in BY98 for tractor trailers providing inter-SCF transportation, at least \$19.0M would be saved." Tr. 28/13419. He noted that the Postal Service could easily eliminate the premium in three ways: (1) negotiate rates vigorously with Amtrak, (2) convert the traffic to truck, or (3) restructure the nature of its agreement with Amtrak. Eliminating the premium through any of these approaches would reduce Test Year Periodicals costs by \$15 million. Tr. 28/13420.

In his rebuttal testimony (USPS-RT-9), witness Pickett argues that Nelson overstated the Amtrak premium in four ways: (1) by comparing Amtrak costs only to the cost of non-renewed highway contracts, (2) by assuming that the Postal Service can purchase small increments of highway capacity, (3) by ignoring the fact that Amtrak capacity is purchased on a one-way basis, and (4) by ignoring Amtrak's provision of consolidation services in Chicago. Tr. 43/18527-29.

Pickett's analysis, however, is flawed. First, he ignores the fact that if the Postal Service switched mail from Amtrak to highway transportation, it would not need to send the mail through Chicago to be consolidated. Tr. 43/18541. Second, while Pickett claims that Nelson should have based his savings estimate on the costs of all contracts, rather than just new contracts, the mail that is now being transported on Amtrak would presumably have to be carried on new contracts or renegotiated contracts. Tr. 43/18543-49. Third, Pickett incorrectly states that Nelson should have included in

his analysis the cost of returning empty trucks to the origin facility. As admitted by both Pickett and Young, highway contracts can be structured so that truckers can carry another commodity on the backhaul after delivering the mail on the outbound run. Tr. 43/18551-52, 18604. Finally, Pickett mischaracterizes Nelson's calculations, claiming that Nelson assumes that highway capacity can be purchased in infinitely small increments. Tr. 43/18528. What Nelson did state, which Pickett admitted on cross examination, was that the Postal Service can procure different sizes of trucks depending on the volume to be hauled. Tr. 43/18552-53. This clearly is true.

Nelson also estimated that the Conrail break-up will reduce Test Year freight rail transportation costs, pointing out that "[a] fundamental premise of the Conrail break-up transaction was that intermodal rates in the Conrail service area would drop by approximately 10% as a result of increased competition." Tr. 28/13421. Taking these savings into account reduces Test Year Periodicals costs by an additional \$1 million. Tr. 28/13421.⁷

d. The Postal Service Again Failed to Correct an Obvious Flaw in its Method for Rolling Forward Supervisory Costs

As witness Buc (DMA-T-1) testified and DMA discusses more fully in its initial brief, to which Periodicals Mailers are signatories, the Postal Service's roll forward method fails to take into account the obvious fact that when cost reduction programs

⁷ Another potential source of freight rail savings is volume discounts. Although the Postal Service declined to provide copies of its contracts with railroad companies to Periodicals Mailers, the Postal Service has indicated in testimony that it has not sought volume discounts in its contracts. Tr. 43/18612. Yet, as witness Nelson testified, while "[t]he Postal Service may not be the largest of rail intermodal shippers,...It is easily large enough to command volume discounts in a competitive marketplace." Tr. 28/13421.

reduce direct labor costs, they also reduce supervisory requirements. Tr. 22/9547-49. This oversight is despite the fact that the Postal Service clearly understands the strong relationship between direct labor workhours and supervisory workhours, stating in its own documents: "As in the case of mail processing supervision, these costs are largely a function of the workhour-related costs of each of the supervised activities." Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 1998; USPS LR-I-1 at 2-4. In Docket No. R97-1, the Commission corrected this error. PRC Op. R97-1 at para. 2155. Periodicals Mailers encourage the Commission to do so again in this case. Making this correction would reduce Test Year Periodicals costs by \$3 million.

B. The Commission Must Perform a Final Adjustment to Test Year Periodicals Costs to Ensure That the Mail Mix Used for Estimating Periodicals Costs Is Consistent With the Mail Mix Used to Estimate Periodicals Revenue

PRC Order No. 1294 (May 26, 2000) and P.O. Information Request No. 16 (July 14, 2000) required the Postal Service to update its estimates of Test Year costs and revenues using Fiscal Year (FY) 1999 as the base year. In performing these updates, the Postal Service used Government Fiscal Year (GFY) 1999 as its base year for estimating TYAR costs and Hybrid Year FY 1999 Q3 – FY 2000 Q2 as its base year for estimating TYAR revenues. While the Postal Service's use of different base years for estimating costs and TYAR revenues is not necessarily a flawed approach, consistency requires that a final adjustment be made to TYAR costs to ensure that the mail mix upon which these costs are based is consistent with the mail mix underlying the TYAR revenue estimate. Tr. 38/17077-17078. Therefore, should the Commission

decide to use FY 1999 as the base year, it must make the final adjustment to TYAR Periodicals costs calculated by MPA witness Cohen.

In this proceeding, the Postal Service has, on several occasions, noted the importance of performing final adjustments to take into account changes in mail mix. USPS-T-28 at 31-32; Motion of the United States Postal Service for Clarification or Reconsideration of P.O. Information Request No. 18 (August 1, 2000) at 7 (Motion). In fact, the Postal Service even noted that the use of different base years for estimating TYAR costs and TYAR revenues was reasonable because final adjustments take into account differences in mail mix, stating: "the roll forward model incorporates 'final adjustments' for many subclasses permitting additional means by which to more closely align costs with mail mix." Motion at 7. We agree with the Postal Service on this point.

Since the Postal Service justifies the use of different base years for estimating costs and revenues in part on the existence of final adjustments to "align costs with mail mix," the Postal Service's failure to make a final adjustment to TYAR costs for Periodicals is a serious omission. In fact, the Postal Service did make adjustments for some subclasses, even when the final adjustment was smaller than the amount estimated by Cohen. Tr. 38/17078; USPS-LR-483.

As Cohen reported in her supplemental testimony, there was more mailer worksharing in the Hybrid Year than in GFY 1999. Tr. 38/17078. To correct for this difference, Cohen calculated final adjustments that reduce TYAR costs for Periodicals by \$39 million. Tr. 38/17078. For the reasons given by the Postal Service and because MPA witness Cohen's testimony is uncontradicted by any party, these final adjustments

should be made to TYAR costs for Periodicals. This and the other cost reductions discussed above are displayed in the following table:

**Table 1. Periodicals Test Year Cost Reductions
(Millions of Dollars)**

Cost Reduction Initiative	Cost Reductions
Postal Service Cost Reductions	\$130
Line of Travel Requirement	\$23
Carrier Route Sacks, L001, and Combining Automation and Nonautomation Flats in Sacks and on 5-Digit Pallets	\$15
Memorandum of Understanding on Vertical Flats Casing	\$7
Equipment and Productivity Enhancements ¹	\$47
Air Transportation	\$11
Breakthrough Highway Transportation Productivity ²	\$12
Bundle Breakage	\$15
Periodicals Mailers Additional Cost Reductions	\$49
Correction to USPS Estimate of Cost Savings from Reduced Bundle Breakage	\$6
Correction to USPS Estimate of Cost Savings from the AFSM 100	\$24
Addition of Rail Transportation Cost Savings	\$16
Addition of Supervisors Cost Savings ³	\$3
Final Adjustments	\$39
Total Cost Reductions	\$218

Source: Tr. 38/17075-76, Tr. 46-C/20872-75, 20956.

¹ While witness Degen identified only \$6 million in savings from Equipment and Productivity Enhancements, Tr. 38/17330, the Postal Service included \$47 million for improved equipment, improved manual flat sorting productivity, and better-than-expected performance of AFSM 100s in cost savings in its FY 1999 update. Tr. 46-C/20872-76, USPS-LR-I-408.

² Cost savings calculated by multiplying \$100 million in transportation breakthrough productivity, POIR 14, Attachment I, by the Periodicals proportion, 12 percent, of Test Year highway transportation costs. USPS-T-14, Exhibit USPS-14K at 43-44.

³ Cost savings calculated by multiplying \$93 million in supervisor cost savings, Tr. 22/9548, by the Periodicals proportion, 3 percent, of Test Year supervisors costs. USPS-T-14, Exhibit USPS-14K at 1-2.

C. The Commission Should Recommend Costing Methodology Changes That Improve Cost Attribution and Distribution

The Periodicals Mailers proposed a number of cost attribution and distribution methods that measure and distribute attributable costs more accurately than those originally proposed by the Postal Service. Postal Service witness Degen has acknowledged that several of these methods are superior to or acceptable alternatives for what was contained in the Postal Service's Request. See Tr. 38/17331.

1. The Commission Should Stand by its Docket No. R97-1 Approach to Distribution of Mixed Mail Costs and Should Adopt the Analogous Approach to Allied Not Handling Costs That is Proposed by the Postal Service and Supported by Witnesses Stralberg, Cohen and Sellick

In every rate case since Docket No. R90-1, witness Stralberg and others have drawn attention to the alarming and seemingly inexplicable growth in mail processing costs for Periodicals and other manually processed flats since FY 1986. Stralberg has demonstrated that: (1) the highly anomalous cost increases occurred concurrently with the major shift to automation of letter mail, (2) the cost increases were also concurrent with a major increase in the proportion of mail processing costs for which no subclass information is available from IOCS tallies, and (3) the traditional mail processing cost attribution and distribution methodology (using IOCS tallies, since R97-1 grouped into MODS cost pools) fails to identify the real chains of causality that drive mail processing costs in today's processing environment.

Two critical issues confront the Commission regarding mail processing costs. One is volume variability, which we discuss below. The other is how to attribute the

approximately 55% of such costs that cannot be linked directly to specific subclasses or special services by IOCS tallies.

There is little dispute that attributable mail processing costs associated with "direct" tallies should be distributed in proportion to the subclasses and special services indicated by those tallies.⁸ There is also general agreement that MODS workhour and wage-related data should be used for the purpose of assigning the appropriate weight to each IOCS tally. There is now even more agreement than ever before between the Postal Service and intervenors that for piece-distribution operations, mixed-mail and not-handling costs should be distributed narrowly, while for allied operations, these costs should be distributed broadly.

We strongly support the Postal Service's decision to broadly distribute not handling costs in allied labor pools as a logical and necessary improvement to the methodology adopted in Docket No. R97-1. No participant has sponsored testimony to the contrary, and UPS witness Sellick has indicated his agreement. Tr. 27/13125. Our disagreements with the Postal Service can be reduced to two fundamental issues: (1) how to broadly distribute "mixed mail" costs in "allied" cost pools; and (2) while agreeing on the need to broadly distribute allied not-handling costs, ways to improve

⁸ The only exception is witness Degen's proposal that direct tallies recorded at cost pools that he calls "support" pools should be ignored in favor of a presumption that direct costs incurred by personnel in such pools are just "incidental" and therefore should be distributed proportionately over all other costs. As Stralberg pointed out, these "incidental" costs, about which subclass information is available, amount to more than \$80 million, not including piggyback costs. Tr. 24/11388.

We agree that even cost attribution based on "direct" IOCS tallies may include a bias, because it ignores such issues as the fact that workers tend to work harder during peak processing hours than in off-peak hours. Tr. 38/17282-83. However, in the absence of Postal Service data that make it possible to

this distribution by utilizing IOCS data that the current USPS method ignores, *e.g.*, question 19 data.

a. Mixed mail and not handling costs in allied cost pools should be distributed broadly

In Docket No. R97-1, the costing methodology the Postal Service proposed implicitly assumed that activities performed and costs incurred in one MODS based cost pool are completely insulated from activities and costs in other cost pools. Witnesses Stralberg and Cohen argued that this assumption is unjustified. Docket No. R97-1, Tr. 36/19285-87 and Tr. 36/19225-29. In particular, they contended that the so-called "allied" cost pools in MODS offices exist in large part to serve other cost pools, *e.g.*, pools that perform piece distribution, and that it therefore would be particularly erroneous to use the limited "direct" tallies at each allied pool as the sole basis for distributing the very large mixed mail and "not handling" costs at those pools. USPS-T-17 at 26.

The Commission agreed with Stralberg's and Cohen's analysis. PRC Op. 97-1, para. 3143, 3146, 3173. It distributed allied mixed mail costs broadly, *i.e.*, over the combined direct costs in all MODS cost pools.⁹

In this case, the Postal Service itself proposes a further improvement, a broader distribution of "not handling" costs incurred at allied cost pools. But its initial filing also

analyze such phenomena (as is the case in this docket), all attributable costs associated with "direct" tallies should be distributed according to the subclass information on such tallies.

⁹ The Commission's method first distributed those mixed mail tallies that, through answers to IOCS question 19 could be associated with a particular mail shape, over "direct" costs with corresponding

took a step backward from what the Commission did in Docket No. R97-1, proposing to distribute allied mixed mail costs based upon direct costs within the allied pools only, ignoring the considerable evidence cited by the Commission in Docket No. R97-1 that a broader distribution of allied mixed mail costs is more justified.¹⁰ It did this despite the fact that the Postal Service had no new, reliable evidence to support a change in distribution methodology and with no change in the very small proportion of direct tallies at allied operations.¹¹

Thankfully, the Postal Service has modified its position during the course of this proceeding. In an interrogatory response, as well as in his rebuttal testimony, Postal Service witness Degen, the main proponent of the pool-by-pool cost distribution method, acknowledged the reasonableness of an intermediate approach that would distribute allied mixed mail costs broadly, but within the various item and container categories recorded on the mixed and direct IOCS tallies. Tr. 15/6515-32, Tr. 38/17322-23. The record therefore presents three possible approaches to allied mixed mail cost distribution:

shape identification. Apart from being limited to mixed mail tallies in allied cost pools, this is essentially the same method used prior to Docket No. R97-1 to distribute all mixed mail costs.

¹⁰ Strictly speaking, the Postal Service's initial proposal distributed platform mixed mail costs over the direct costs in all allied pools, while mixed mail costs in other allied pools were distributed within their respective pools only. For Periodicals, whose direct costs tend to be concentrated in opening and pouching units much more than on platforms, this is the worst of all conceivable distribution alternatives. USPS-T-17 at 27-40.

¹¹ In its Docket No. R97-1 decision, the Commission cited two factors leading it to a broad distribution: (1) allied workload consists of "both the piece-distribution support function and the bypass processing function;" and (2) the potential for bias in allied operations is high because direct tallies comprise such a small proportion of total tallies in allied operations. PRC Op. R97-1, para. 3170-3174. As described by MPA witness Glick, the evidence in this record strongly supports these findings. Tr. 24/11219-21. Furthermore, as Mr. Glick testifies, the Postal Service has performed no new reliable study of allied cost causation. Tr. 24/11221-22.

- (1) the Commission's R97-1 method supported by the Periodicals Mailers;
- (2) Degen's compromise method, which distributes allied mixed mail costs broadly, but within item and container categories; and
- (3) the flawed method originally proposed in the Postal Service's direct case.

Of the three methods, only the first uses the shape association provided by question 19 data. If the Commission were to adopt the Degen compromise, it should still use it in conjunction with the question 19 data as explained by Stralberg.

Tr. 24/11378-79 and 11386-89. The advantages of using question 19 data to improve the distribution are discussed in the next section.

While the second method is preferable to the Postal Service's original proposal, Stralberg's testimony provides additional rationale for why the Commission should retain its Docket No. R97-1 method, based on the considerable likelihood of bias in the current item and container scheme, due particularly to the highly asymmetric treatment of pallets relative to other container types.¹² Witness Glick also explains that the evidence on this record strongly supports the Commission's rationale in Docket No. R97-1 for a broad distribution of allied mixed mail costs. Tr. 24/11219-22. For

¹² See Tr. 24/11386-8. However the Commission distributes mixed mail costs in this docket, it should urge the Postal Service to address this asymmetry as soon as possible, preferably before the next rate case. On rebuttal, Degen asserted that he has found no evidence of bias in the current method of recording pallet data. However, Degen's rebuttal did not address Stralberg's explanations of why such a bias is practically unavoidable under the current scheme. Instead, it faulted Stralberg for ignoring a previously unpublished 1995 platform study described in Degen's direct testimony (USPS-T-16 at 65-66), which he says found no evidence of bias. Without getting into the grave inadequacies of that study (partially reported in this case as LR-I-115), already exposed by witness Glick (Tr. 24/11221-22), we must note that pallets today are used for many more purposes, for example, carrying trays of letter mail or empty trays and to a much larger extent than they were in 1995. As Stralberg explains, the IOCS is simply unable to record these forms of pallet usage, and this inadequacy is bound to cause bias, whether Degen is able to detect it or not. Tr. 24/11386-88.

these reasons, we strongly urge the Commission to stay the course and recommend its Docket No. R97-1 method.

We also strongly recommend that the Commission distribute allied "not handling" costs broadly, an approach that all parties in this proceeding believe to be an improvement. As a further refinement of that method, we recommend that the Commission combine it when possible with the use of question 19 shape associations, as advocated by Stralberg and discussed in the following section.¹³

b. IOCS Information pertinent to cost distribution should not be ignored or assumed to be less accurate than MODS cost pool affiliation

IOCS clerks record extensive information for each sample taken. Stralberg has argued strongly in this case and in Docket No. R97-1 that, while there is much information that IOCS clerks cannot possibly record, IOCS-based distribution should make maximum use of the information that is recorded when it is relevant to cost distribution and absent evidence that it might be biased in some way. Tr. 24/11354, Tr. 26/13852. Below we focus on two particular types of information that the Postal Service ignores, even though its use would provide a more accurate cost distribution: (1) question 19 data and (2) window service data on tallies taken in mail processing cost pools.

¹³ The word "broadly" in this case has a slightly different meaning than in Docket No. R97-1. "Broad" distribution of allied non-direct costs refers in this case to distribution over Function 1 cost pools only. Under the Commission's Docket No. R97-1 method of broad distribution, allied mixed mail costs were distributed also over the Function 4 pools. We believe the restriction to Function 1 cost pools is appropriate, given that Function 4 pools occur in physically separate facilities.

Question 19 data indicate the type of operation at which an employee was observed by the IOCS clerk. In many cases, this information makes possible more accurate conclusions about the type of mail to which the costs of an employee's time should be attributed. For example, if an opening unit clerk was at a letter sorting operation, it is reasonable to infer that this employee must have been involved in some activity serving letter mail as opposed to other mail shapes, even if recorded as not handling mail. Similar conclusions can be drawn if the employee was observed at a flat sorting operation.

Stralberg's testimony proposes to extend the traditional (pre-R97-1) use of question 19 data, showing that it can also provide information about employees observed while on break or handling empty containers. Tr. 24/11378-9. He points out that question 19 data can associate a mixed mail or not handling tally not only with a specific shape but a specific sorting technology as well. Tr. 24/11384-6. He illustrates applications of question 19 data that can improve the current MODS-based distribution scheme. These include distribution of empty container and not handling tallies at Function 4 cost pools, where the percentage of such tallies with applicable question 19 data is much larger than in Function 1 allied pools. Tr. 24/11385. He shows that question 19 data can be used to enhance distribution of allied mixed and not handling costs, separate from or in conjunction with the Postal Service's use of mixed mail item and container data.

Question 19 data are, unfortunately, available only for a relatively small subset of allied mixed mail and not handling tallies. However, Stralberg shows that the distribution of shapes indicated by question 19 data for non-direct tallies is often very

different from the direct tally shape distribution. This strongly indicates that there are still issues regarding the "proportionality assumption" upon which the Postal Service justifies pool-based distribution of non-direct tallies; it therefore is essential that the Postal Service continue to pursue improved methods for attributing mail processing costs.¹⁴

Besides question 19 data, the Postal Service's method also ignores IOCS question 18 information indicating that employees clocked into mail processing operations actually worked at postal windows. Stralberg's recommendation in such cases is simply to assume that the IOCS clerks recorded what they really saw and to distribute the costs accordingly. Degen's recommendation is to ignore all information recorded except the one piece that says the employee was clocked into a certain MODS number. Degen denigrates Stralberg's report from Periodicals Operations Review Team visits that clerks at DDUs often are reassigned among mail processing, window service and administrative duties as "anecdotal" evidence and says it is

¹⁴ Witness Degen's attempt at rebutting Stralberg's question 19 proposals shows that he doesn't fully understand them. Degen produces a table (Tr. 38/17349) showing that a greater percentage of mixed mail item and container tallies can be affiliated with shape through the item type recorded (e.g., flat trays, letter trays, loose parcels, etc.) than through question 19 data, ignoring the fact that most of the tallies for which Stralberg proposes to use question 19 data are either empty container or not handling tallies, for which *no* shape related information is available. He seems to have missed the point that use of question 19 data is not inconsistent with the use of item and container information – the two can be used together, or separately.

Degen also seems to ignore the Postal Service's own use of question 19 data to analyze Non-MODS cost data. Stralberg's proposed use of such data in Function 4 pools is essentially equivalent to the Postal Service's use of it for Non-MODS data. Tr. 24/11382. Degen's objection to use of question 19 data for empty containers appears to be based on the fact that it would give results different from Degen's proportionality assumption, and that he therefore thinks it must be wrong. But he should instead take such differences as indications that the proportionality assumption, which he never examined critically, could be wrong.

unknown how often this occurs. Tr. 38/17310. But the IOCS tallies, presumably a little more than anecdotal, show that it occurs a great deal.

c. Summary of distribution of mail processing costs proposed by Periodicals Mailers

Periodicals Mailers urge the Commission to recommend the improvements in the attribution and distribution of costs presented by witnesses Stralberg, Cohen, and Glick – specifically:

1. to distribute “not handling” costs at allied MODS cost pools broadly over the direct plus distributed mixed mail costs at all MODS Function 1 cost pools, as the Postal Service proposes, because “the large allied not handling costs are mostly driven by the need to serve piece distribution operations” (Tr. 24/11369);
2. to distribute “mixed mail” costs at allied MODS cost pools, including empty equipment costs, broadly over the direct costs at all MODS Function 1 cost pools, as the Commission did in its Docket No. R97-1 Opinion and Recommended Decision;
3. to distribute “not handling” and “mixed mail” costs at allied non-MODS and BMC cost pools broadly over all pools within the respective facility categories;
4. to distribute “not handling” and “mixed mail” costs at allied and support pools, as well as Function 4 pools, by specific shape and sorting technology, when that is made possible by IOCS question 19 data;
5. to distribute the more than \$80 million of direct costs in “support” pools according to the subclass or special service identified by the IOCS tallies; and
6. to distribute “migrated” not handling costs related to window service in proportion to other window service costs.

2. A Change in the Rural Carrier Mail Shape Adjustment Using Annual Data Will Result in a Reduction of Periodicals Costs of \$17 Million

Witness Cohen explains:

The Postal Service uses data from the National Mail Count (NMC) to determine rural carrier costs by cost driver and data from the Rural Carrier Cost System (RCCS) to distribute these costs to mail subclasses. Because of differences in the ways these two data systems define flat mail, the Postal Service recodes some RCCS letters as flats so that the resulting flats percentage for the RCCS data is consistent with the cost data from the NMC. In this case, the Postal Service is proposing to determine the proportion of letters to recode as flats by comparing the RCCS flats percentage for the four-week period of the NMC with the NMC flats percentage.

While this approach may have intuitive appeal because it compares data from the same time period, it is inappropriate because RCCS data during the four-week period of the NMC, or any other four-week period, is infected with high sampling error. MPA/USPS-49. To illustrate this point, the 95 percent confidence interval for the four-week RCCS flats percentage is 3.2 percentage points wide. Because each percentage point in the RCCS flats percentage has a \$5 million impact on Base Year 1998 Periodicals costs, this uncertainty range is unacceptably high. For this reason, annual RCCS data, which contain much less sampling error, MPA/USPS-49 (filed on May 12, 2000), should be used to determine the RCCS flats percentage. Witness Glick provides more detail on this point.

Tr. 24/11292 (footnote omitted); see also, Tr. 24/11223-26.

Postal Service rebuttal witness Degen acknowledges that this change will result in a reduction of base year Periodicals costs of \$17 million. Tr. 38/17331. This reduction is uncontradicted on this record.

3. The Commission Should Reject Witness Raymond's Engineered Standards (ES) Study as a Basis for Attributing Carrier Costs, But if it Does Use the ES Study, It Must Also Use the Corresponding Volume Variabilities and Accrued Cost Adjustments Developed by Baron from the Same Data, Which Would Reduce Periodicals Base Year Costs by \$49 Million

As discussed more fully in the Initial Joint Brief Concerning Attribution Of Carrier Costs On Behalf Of Advo, Inc., et al., of which Periodicals Mailers are co-sponsors, Postal Service witness Raymond's Engineered Standards (ES) study, based on which the Postal Service proposes an enormous shift of carrier costs to Periodicals, does not meet the Commission's minimal foundational standards for statistical evidence, possesses grave methodological deficiencies, and produces demonstrably biased and unreliable results. The Commission should therefore reject the ES study for the purpose of estimating carrier costs.

However, if the Commission does use the ES study for carrier cost attribution, then, as Postal Service witness Baron and MPA witness Crowder both testified, it must also use the corresponding volume variabilities and accrued cost adjustments developed by Baron from the same data. Tr. 32/16190; Tr. 43/18704-08. All pertinent testimony of record supports, and no party has questioned, the view that to develop reasonable estimates of volume variable load costs, the ES volume variabilities must be used with the ES accrued cost estimates.

The Postal Service's originally filed Base Year 1998 attributable load time costs used ES proportions of carrier time but variabilities based on the LTV. USPS-T-12 Work Papers, Worksheet 7.0.3.1. Witness Baron's final revised attributable load time costs for Base Year 1998 more properly use ES proportions and ES variabilities.

USPS-RT-12 Work Papers, Worksheet 7.0.3.1. The result is a reduction of \$34.8 million in Periodicals attributable load time costs in Base Year 1998, which increases to \$49 million when piggyback costs are added.

4. New City Carrier Drive Time Variability Assumptions for Routine Dismounts and Loops Will Reduce Base Year Periodicals Costs by \$39 Million

Based on a refinement of an analysis he first presented in Docket No. R97-1, MPA witness Nelson estimated a variability of zero for the drive time associated with routine dismounts. Tr. 28/13414-16. On rebuttal, witness Baron also proposed a zero variability for routine dismounts, based on information from operations analysts that virtually all dismounts stops have excess capacity. Tr. 43/18727-28. Separately, witnesses Crowder (Tr. 44/19397-99) and Baron (Tr. 43/18726-27), analyzing new ES satchel weight data, estimated that drive time associated with routine loops has zero variability as well.

No testimony has contradicted these well-supported analyses, and the Commission should accept them. The estimate of zero variability for the drive time associated with routine dismounts and loops reduces Base Year Periodicals costs by approximately \$39 million.

5. The Commission Should Use the New Variability Estimates for Highway Transportation Developed by Witness Nelson and Refined by Witness Bradley

As described by witness Nelson in his direct testimony, witness Bradley's proposed quantitative analysis of the volume variability of purchased highway transportation costs is inconsistent with the Postal Service's operating practices and

significantly overstates the true variability of these costs. Indeed, because the Postal Service has "considerable latitude to alter the sizes of vehicles used on most routes in response to volume changes *without adding trips*," and because the Postal Service can further adjust routes of any necessary additional trips in ways that "provide more direct service," the Service's highway transportation models "overstate the true variability of cost with respect to the volume of mail being moved." Tr. 28/13409-10.¹⁵ Upon recalculating variabilities within a framework that is "consistent with Postal Service operating practices," Tr. 28/13411, witness Nelson concluded that the "total volume variability for purchased highway transportation is approximately 53.1 percent." Tr. 28/13413. By contrast, witness Bradley's methods showed the variability of purchased highway transportation to be approximately 81.6 percent. Tr. 43/18467.

The difference is significant: Nelson concluded that the Postal Service's methodology overstated highway transportation costs attributable to Periodicals by \$88 million in the Base Year. Tr. 28/13413.

On rebuttal, Bradley argued with Nelson's econometric methods, but also suggested a number of refinements, some of which, such as including the number of runs as a right-hand-side variable, appear to be useful. See, e.g., Tr. 43/18383.

At the same time, the record makes clear that both the Postal Service's own witness, Dr. Greene, and UPS witness Neels have demonstrated the flaws in Bradley's

¹⁵ The size of the vehicle chosen and the route to which the vehicle is assigned are of secondary importance to the Postal Service, where "transportation requirements are set primarily by processing and delivery schedules at the facilities being served. . . and 'to make efficient use of postal employees, who account for about 80 percent of postal operating costs.'" Tr. 28/13409.

“mean-centering” method of calculating translog elasticities from only the first-order coefficients. Tr. 46-E/22078-79, 21907-08, 21922-26; Tr. 43/18913-15. As a result, the record shows that the Base Year variabilities presented by Bradley are analytically unsound and intrinsically unreliable. Furthermore, the results reported in Bradley's rebuttal testimony preserve the “per run” normalization of the cost variable introduced by Nelson to control for the bias introduced in Bradley's initial models by variations across contracts in the number of runs. Tr. 43/18413-15, 18385. Witness Nelson's basic postulate and illustration regarding the way variation in runs causes an upward bias in Bradley's initial results still stands.

Bradley attempts to impose a restriction on his recalculation of Nelson's variabilities, *i.e.*, a hypothesized “plus/minus 1” relationship between the coefficients. Tr. 43/18415. However, this restriction results from Bradley's perpetuation of his erroneous assumption that “all CFM [cubic-foot miles] are created equal,” whether they result from changes in trip length, frequency or vehicle capacity. This assumption ignores the demonstrated fact that capacity changes affect costs in different ways than do frequency changes. Tr. 28/13410-11.

In response to an oral cross-examination request (Tr. 43/18462-64), Bradley provided a summary of the estimated parameters developed in his rebuttal testimony as corrections to Nelson's estimates. By Bradley's own description, these corrections fix all of the “defects” he was able to identify in Nelson's econometric analysis. Tr. 43/18413-15, 18461. The corrected regressions yield a composite variability of

approximately 65 percent. See Tr. 43/18414.¹⁶ While these results are closer to Bradley's own estimate of 82 percent composite variability than was Nelson's original estimate of 53 percent, they still substantiate a significant decrease in variability when Nelson's adjustment for variation in runs is taken into account. Periodicals Mailers believe that the Commission should adopt Bradley's refinements to Nelson's estimates as the best available evidence for estimating highway transportation variabilities.

6. A New Distribution Key for Amtrak Roadrailer Costs Will Result in a Reduction in Periodicals Base Year Costs of \$2 Million

Another distribution in need of correction involves the new Roadrailer service from Amtrak. A hybrid in the transportation field, Roadrailer is "a type of trailer that can operate over a highway in a normal tractor/trailer combination, or be quickly adapted to ride on rails *without* the types of intermodal rail cars normally required to transport highway trailers and shipping containers [Roadrailer provide] a new capability for truckload movement." Tr. 28/13413. Roadrailer is not sampled by TRACS, and, as a result, the composition of mail moving on Roadrailer was not known by the Postal Service when it filed this case. In the absence of subclass data, the Postal Service, mistakenly it turns out, assumed that the mail carried on Roadrailer was similar in composition to the mail carried on Amtrak. Tr. 28/13413.¹⁷

¹⁶ Rough approximations of the corrected composite variability can be calculated using the dollar amounts in witness Bradley's Table A1, USPS-T-18 at 64, in combination with Bradley's Response to Request Made by MPA, et al. During Cross Examination (Aug. 30, 2000) at 2 and witness Nelson's Table 1, Tr.28/13424. Periodicals Mailers accept witness Bradley's "box" column variabilities. See Bradley, USPS-T-18, at 64, Table A1.

¹⁷ One aspect of Roadrailer transportation that appears not to be in dispute is that, as Witness Nelson testified, "because Amtrak is only investing in this technology to attract new business, it can reasonably

In his direct testimony, Witness Nelson suggested that because “the speed, reliability, distance and truckload volume characteristics of Roadrailer service” are similar to that of inter-SCF highway transportation, Roadrailer costs should be distributed to classes and subclasses “using the inter-SCF distribution key.”

Tr. 28/13413-14. On this basis, Witness Nelson calculated that “USPS BY98 treatment of Amtrak Roadrailer movements overstates Periodicals costs by \$3.1M.” Tr. 28/13414.

In response, “[r]ather than adopt or oppose” Witness Nelson’s calculations, the Postal Service “conducted a special study of mail on Roadrailleurs.” Tr. 43/18531. The study showed that “Roadrailleurs carry a *higher* percentage of Periodicals than inter-SCF highway, but a *lower* percentage than conventional Amtrak.” Tr. 43/18531 (emphasis added). See USPS-LR-I-433. As a result, the Postal Service now recommends employing this new distribution key – a move that reduces base year Periodicals costs by \$2.3 million. Periodicals Mailers agree that use of this new distribution key for Amtrak Roadrailleurs is appropriate.

7. Correcting the USPS’s Rail Empty Equipment Distribution Will Reduce Periodicals Costs by \$5 Million

As MPA witness Nelson testified, the Postal Service’s method for distributing the costs for empty equipment being transported by rail is incorrect. Specifically, its method assigns all of these costs “as if they were caused by the mail that moves on freight rail and Amtrak.” Tr. 28/13414. This, however, is not the case. The Postal Service uses the empty equipment that it moves by rail to carry mail on both highway and rail

be concluded that Roadrailleurs are not being used to divert the Postal Service volume that Amtrak already moves” – a volume that *is* sampled by TRACS. Tr. 28/13413.

transportation contracts. For this reason, Mr. Nelson distributes these costs based upon a key that includes costs for all modes of rail and highway transportation. This adjustment reduces base year Periodicals costs by about \$5 million. Tr. 28/13414. The Postal Service has now explicitly agreed with Witness Nelson's proposal. As stated in witness Degen's rebuttal testimony, he was informed that the Postal Service "does not challenge this redistribution." Tr. 38/17332.

IV. MAIL PROCESSING COST VARIABILITIES ARE LESS THAN 100%

In this section, Periodical Mailers will show that the Commission's previous refusal to accept mail processing variabilities of less than 100% must be reversed, based upon the record evidence in this proceeding.

A. The Commission Should Accept the Postal Service's Econometric Estimates of Mail Processing Volume Variability

As shown below, on the basis of the record evidence and under governing legal standards, the Commission should accept the Postal Service's estimates of the variability of mail processing costs.

1. Record Evidence

Periodicals Mailers strongly believe that the most appropriate and accurate measures of mail processing volume variability presented to the Commission on this record are those contained in Witness Bozzo's well-reasoned and carefully crafted econometric analysis of mail processing operations. Those estimates are strongly supported by the operational analyses of witnesses Degen, Cohen, and Stralberg that show why volume variability is less than 100 percent. USPS-T-16 at 15-54; Tr. 24/11284, 11368. As described in depth by these witnesses, many components of

mail processing, including setup and takedown time and gateway operations, are driven by factors other than volume and will not increase proportionately with changes in volume (see, e.g., Tr. 38/17316-19). Furthermore, the existence of economies of scale in postal operations is completely consistent with the pattern of industry production in this country. Even witness Neels admits that many industries have production capacity concentrated in a small number of companies, indicating the existence of scale economies. Tr. 27/13024-26.

The Commission should recognize that many of the technical arguments made by witnesses Smith and Neels are simply misleading and distracting. Witness Bozzo has shown that the overall finding that mail processing volume variability is less than 100 percent is quite robust. USPS-T-15 at 116-127 and 151-152. As witness Greene makes clear, the only models that produce a volume variability estimate of 100 percent show a flagrant disregard for the data and for proper econometric practice. Tr. 46-E/22040-42.

Witness Bozzo and the Postal Service have been open and responsive to constructive suggestions from the Commission and others. In response to the Commission's concerns about witness Bradley's analysis in Docket No. R97-1, witness Bozzo has refined the analysis into a second-generation, significantly-improved quantification of mail processing volume variability. His refinements include the addition of wage, capital, and network variables, the addition of a full year's worth of lagged variables for adjustment, and a more modest scrubbing of the data. Tr. 24/11283. Witness Bozzo has also investigated the impact of alternative data scrubbing methods and the use of the manual ratio and has found that they do not significantly affect the

volume variability estimates. USPS-T-15 at 140-147. In sum, the analysis has been carefully constructed in accordance with standard economic theory, accepted econometric practice, and the operational realities of the Postal Service.

Including additional lagged variables and variables for wages and capital, and using six years' worth of data, also render inconsequential questions about the appropriate length of run that should be used in quantifying mail processing variability. Witness Bozzo's model accurately reflects the cost response of mail processing to volume changes over the course of a rate cycle. Tr. 46-E/22195-99. The Commission has argued that the rate cycle is the appropriate length of run to consider. R97-1 Opinion at 79-80. In the context of a rate case, it is important to understand how mail processing costs will change with volumes over several years in a relatively fixed network of mail processing facilities, and this is precisely the relationship that the fixed effects model estimates. The differences across sites do not represent changes that occur over time but contrasts that are relatively fixed; it is unlikely that Madison will ever become Milwaukee, and this transformation will certainly not happen over a two-to-three year period. Tr. 38/17384-85. Furthermore, volume variability will actually be lower in the long run than in the short run. This is due to the fact that operations can be optimally configured when all factors of production are changeable.

Two late-breaking developments in the R2000-1 docket underline the robustness of the conclusion that mail processing volume variability is less than 100 percent. First, the Commission's Fourth Notice of Inquiry (NOI 4) asked intervenors to investigate models that include time-specific fixed effects that had been omitted in witness Bozzo's original testimony. The responses of witnesses Bozzo, Neels, and Elliott all show that

these time-specific fixed effects are statistically significant but that their addition to witness Bozzo's model has essentially no impact on the estimated volume variability factors. Tr. 46-E/22254, 22296; Tr. 43/18659. Second, the response of witness Neels to NOI 4 describes his late discovery of two errors in witness Bozzo's calculation of the autocorrelation transformation in his model. However, far from suggesting that volume variability is 100 percent, the corrected version of this transformation results in even lower volume variability factors than in the uncorrected version. Tr. 46-E/22310.

These two recent developments show the robustness of the Postal Service's proposed model through a cycle of refinements provoked by Commission and intervenor insights. In response to Commission concerns regarding the econometric models that Bradley presented in Docket No. R97-1, witness Bozzo conducted a multi-year effort to refine the models, and still the results are remarkably consistent. The same is true in this case. The results of alternative formulations and correction of errors lead to even more refined models that continue to show volume variability to be substantially less than 100 percent. With two cycles of refinement under our belts, it is time for all parties and, we submit, the Commission, to acknowledge the robustness of the econometric estimates.

The weight of the operational and econometric evidence argues strongly in favor of mail processing volume variability factors that are less than 100 percent. There is no evidence to support the contrary conclusion. The Commission should adopt the Postal Service's econometrically and operationally sound estimates of volume variability in place of the traditional but indefensible assumption that volume variability is 100 percent.

2. Legal Analysis

If the Commission nevertheless declines to recognize that a considerable portion of mail processing costs are not volume variable, we respectfully submit that under *National Ass'n of Greeting Card Publishers v. USPS*, 462 U.S. 810 (1983) (NAGCP IV), the Commission would not be free to revert to the assumption that those costs are 100 percent volume variable, or that they are otherwise attributable rather than institutional costs.

The Supreme Court held in NAGCP IV that:

The legislative history supports the Rate Commission's view that when causal analysis is limited by insufficient data, the statute envisions that the Rate Commission will "press for . . . better data," rather than "construct an 'attribution'" based on unsupported inferences of causation.

462 U.S. at 827 (quoting PRC Op. R74-1, pp. 110-11).¹⁸ The Court cited legislative history defining "'attributable' costs as 'capable of objective determination and proof either by empirical observation or deductive analysis,'" such that "unless a reliable connection is established between a class of service and a cost," attribution of costs is "entirely arbitrary." *Id.* at 829 & n.24 (quoting 116 Cong. Rec. 27606 (1970) (remarks of Rep. Udall)). The Court concluded that while the Commission "conscientiously has

¹⁸ The Court embraced the Commission's consistently held view that the Postal Reorganization Act "requires the establishment of a sufficient causal nexus before costs may be attributed." *Id.* at 826. "The stricture of this approach and the unavailability of complete data led in the first two rate proceedings to recommended decisions which, by the Commission's own account, did not attribute to each class all the costs that were likely the result of providing the particular service. The Commission noted, for instance, that 'where the record is incomplete or inadequate for [volume variability] analysis, we have not attempted to carry the attribution process farther than our data permit. Instead, we have assigned the relevant costs according to the noncost standards of the statute.'" *National Ass'n of Greeting Card Publishers v. USPS*, 569 F.2d 570, 581 & n.35 (D.C. Cir. 1976) (quoting PRC Op. R74-1, p. 483), *vacated on other grounds*, 434 U.S. 884 (1977).

attempted to find causal connections between classes of service and all postal costs . . . where the data are sufficient," the Commission otherwise "is to assign remaining costs" as institutional costs "on the basis of the other eight factors set forth by § 3622(b)." *Id.* at 834 (emphasis added).¹⁹

Accordingly, if the Commission were to find the evidence in this case insufficient to support the non-volume-variability of the mail processing costs in question, those costs should not be attributed to mail classes but treated as institutional costs. There is no substantial evidence of record to support any such attribution. The Commission could not rely in this regard on a mere assumption of 100 percent volume variability that is not rationally supported by substantial record evidence. See *Mail Order Ass'n of America v. USPS*, 2 F.3d 408, 421 (D.C. Cir. 1993) ("inferences should rest upon some findings that are themselves supported by substantial evidence in the record as a whole") (citations omitted); *Midtec Paper Corp. v. United States*, 857 F.2d 1487, 1498 (D.C. Cir. 1988) ("reviewing court to guard against an agency's drawing inferences that are 'arbitrary,' in relation to facts found, no matter how substantial may be the support for such facts").

These principles apply *a fortiori* where, as here, an agency's assumption is contradicted by substantial record evidence. See *Aeron Marine Shipping Co. v. United States*, 695 F.2d 567, 577-80 (D.C. Cir. 1982); *City of Charlottesville v. FERC*, 661 F.2d 945, 954-55 (D.C. Cir. 1981). "Evidence is not substantial if it is overwhelmed by other

¹⁹ In this regard, the Court rejected the view that a purpose of the Postal Reorganization Act was to "minimize the Rate Commission's discretion by maximizing [cost attribution]." *Id.* at 821-22.

evidence, . . . or if it constitutes mere conclusion." *Olenhouse v. Commodity Credit Corp.*, 42 F.3d 1560, 1581 (10th Cir. 1994) (citations omitted). See also *Johnson v. Office of Thrift Supervision*, 81 F.3d 195, 201 (D.C. Cir. 1996) ("court must consider any evidence that 'fairly detracts' from an agency's findings and conclusions").

As witness Bozzo demonstrated in his direct testimony, the assumption that mail processing costs are 100 percent volume variable was originally adopted in Docket No. R71-1 not on the basis of any evidence but merely as an interim fallback for lack of adequate capability at the time to reasonably estimate the true volume variability percentage. See USPS-T-15, pp. 4-12. Whatever justification may once have existed for that interim approach, it is wholly dispelled by the presentation of substantial record evidence of an improved estimate of volume variability.²⁰ Nor has UPS witness Neels or OCA witness Smith presented any substantial evidence that mail processing costs are 100 percent volume variable.²¹ To the contrary, witnesses Bozzo, Cohen, Degen, Greene, Stralberg, and Elliott have presented overwhelming evidence that a substantial portion of those costs are *not* volume-variable, and under governing legal precedent (discussed below), this evidence should be embraced by the Commission.

²⁰ See *National Resource Defense Council v. Herrington*, 768 F.2d 1355, 1391 (D.C. Cir. 1985) (an agency "may resolve even substantial factual uncertainties in the exercise of its informed expert judgment; but it may not tolerate needless uncertainties in its central assumptions when the evidence fairly allows investigation and solution of those uncertainties"); *MCI Telecom. Corp. v. FCC*, 712 F.2d 517, 535 (D.C. Cir. 1983) ("rates not yet found to be either just, reasonable, and nondiscriminatory or unjust, unreasonable, or discriminatory 'can avoid the stigma of unlawfulness,' at least during a reasonable interim period in which the [agency] is attempting to establish a more permanent rate structure").

²¹ Indeed, witness Bozzo demonstrates in his rebuttal testimony that the analysis of witness Neels, when corrected for obvious flaws, provides further confirmation that a substantial portion of those costs are *not* volume variable. Tr. 46-E/22150-58, 22171-74. The analysis of witness Smith has been thoroughly rebutted by USPS witness Greene, among others. Tr. 46-E/22062-66, 22071-73.

The controlling principle here is that a new methodology should be approved despite its purported flaws (subject to future refinement) where it nevertheless constitutes a clear *improvement* over the methodology in use and is superior to any current alternative. See, e.g., *MCI Telecom. Corp. v. FCC*, 675 F.2d 408, 413-16 (D.C. Cir. 1982); *Natural Resource Defense Counsel v. Herrington*, 768 F.2d at 1390-91. See also *MCI Telecom. Corp. v. FCC*, 627 F.2d 322, 341-42 (D.C. Cir. 1980) ("The best must not become the enemy of the good, as it does when the [agency] delays making any determination while pursuing the perfect tariff"); *Edison Elec. Institute v. ICC*, 969 F.2d 1221, 1227 (D.C. Cir. 1992) ("We do not think that the Commission acted arbitrarily . . . by using the data that are available now and undertaking to incorporate more data into its analysis as they become available in the future").

In the circumstances presented, the Commission need "only to search for *substantial* evidence, not proof positive," that witness Bozzo's volume variability estimates are indeed an improvement over the 100 percent variability assumption. *Public Citizen Health Research Group v. Tyson*, 796 F.2d 1479, 1495 (D.C. Cir. 1986) (emphasis in original). Moreover, "where existing methodology . . . is deficient, the agency necessarily enjoys broad discretion to attempt to formulate a solution to the best of its ability on the basis of available information." *Id.* (citation omitted).

It would be a mischievous rule at war with the requirements for a practical administrative surveillance of expenses to vitiate comparisons with and adjustments from known data because of large gaps in the data. The perfect must not be the enemy of the good. The art of government may involve the science of statistics, but it is a subtler and more complex calling in the ultimate determination required. . . . In appraisal of a record, . . . generous dollops of judgment are proper and perhaps necessary.

Trans World Airlines, Inc. v. CAB, 385 F.2d 648, 658 (D.C. Cir. 1967) (affirming agency decision).

These principles are fully applicable to postal ratemaking. As the Supreme Court declared in *NAGCP IV*: "Allocation of costs is not a matter for the slide-rule. It involves judgment on a myriad of facts. It has no claim to an exact science." 462 U.S. at 825. The Commission has considerable latitude to tailor its judgment to the circumstances. For example, the Commission need *not* "limit attribution to the long-run variable approach" (*id.* at 830) where, as in its initial rate case, the available data permitted only a short-run variability analysis. See *id.* at 815-18. Cf. *United Parcel Service*, 184 F.3d at 843 (affirming Commission decision that certain volume variable costs were not attributable). We respectfully submit that in exercising its judgment, the Commission should embrace witness Bozzo's estimates of the volume variability of mail processing costs as a clear improvement over the 100 percent variability assumption, notwithstanding that further improvements may be feasible in the future.

- B. If the Commission believes that there are remaining questions with regard to the Postal Service's fixed effects model, there are other models on the record that, while not statistically equal to the fixed effects model, nevertheless provide an adequate and supportable basis for quantifying mail processing variability. All these models show variability to be less than 100 percent.**

During the cross-examination of respondents to the Fourth Notice of Inquiry (NOI 4), the Chairman asked witnesses Greene and Neels about an excerpt from the *Handbook of Econometrics* that concerns the joint impact of individual fixed effects and measurement error. Tr. 46-E/22134. The excerpt suggests that an estimated coefficient will be biased upward in a pooled model but downward in a fixed effects

model. In response to the Chairman's questions, witness Greene contended that the result applies only to simple models and would not necessarily apply to more complex models. Tr. 46-E/22135-39. Without contradicting Greene, witness Neels argued that the result would have some heuristic value in assessing the results of more complex models. Tr. 46-E/22318-22.

If one accepts the argument that the results from the simple model have some heuristic value in evaluating the results of more complex models, then the lesson to draw would be that the coefficients of witness Bozzo's pooled model may be biased upward, whereas the coefficients of the fixed effects model may be biased downward. If these biases hold for the volume variabilities—which are not estimated coefficients themselves but are calculated by combining several estimated coefficients—then the volume variabilities from the pooled model would be biased upward, whereas the variabilities from the fixed effects model would be biased downward. Thus the results from these two models could be used to “bracket” a range of values for each cost pool that would contain the true unbiased volume variability.

Table 2 shows the volume variability estimates provided by witness Bozzo using the fixed effects and pooled models.²² If the volume variability estimates for the fixed

²² Note that the composite variability shown in Table 2 does not include the estimates for the Cancellation and Mail Preparation cost pool in order to match the set of cost pools used to calculate the variability composites that are on the record in the cross-examination exhibit for witness Neels. Tr. 15/6381-86. Note further that the estimates in the table are taken from witness Bozzo's original testimony and do not correct for three minor errors. First, a minor data selection error was discovered that had no significant impact on the estimated variabilities. Tr. 46-E/22274, 22296. Second, an error in the autocorrelation transformation that affected the pooled model was discovered by witness Neels, but his correction of this error in his estimation of Model B shows that it had no significant impact on witness Bozzo's estimated variabilities for the pooled model. Tr. 46-E/22274-75, 22305-10. Third, an error in the autocorrelation

effect and pooled models can be used to bracket the true unbiased volume variability, then the true volume variability lies within the range defined by the fixed effects model at the low end and the pooled model at the high end. If this bracketing assumption is correct, the Commission should choose volume variability estimates that lie somewhere in the range between the fixed effects and pooled model estimates.

transformation that affected the fixed effects model was discovered by witness Neels, but the correction of this error was shown by witness Bozzo to result in lower fixed effects variability estimates.

**Table 2. Volume Variability Estimates
for the Fixed Effects and Pooled Models**

Cost Pool	Fixed Effects	Pooled
	[1]	[2]
BCS	.895	.931
OCR	.751	.862
FSM	.817	.913
LSM	.954	.922
Manual Flats	.772	.842
Manual Letters	.735	.845
Manual Parcels	.522	.645
Manual Priority	.522	.642
SPBS	.641	.724
Cancellation/Mail Preparation	.549	.643
Composite	.772	.857

[1] USPS-T-15 at 119-120, and Tr. 46-E/22221 for composite.

[2] USPS-T-15 at 157-158, and *see generally*, Tr. 46-E/22221-22 for composite.

The Commission has ample authority to determine variability in this way. See *United Parcel Service v. USPS*, 184 F.3d at 839 (“When an agency does not ‘entirely disregard two [expert estimates], but [finds] each somewhat in error,’ the court has permitted the agency to take ‘as its own solution a point somewhere between the two expert figures. When neither of two suggested adjustments applied to inaccurate data is completely satisfactory a ratemaking body may fashion its own adjustments within reasonable limits’”) (quoting *Association of Am. Publishers v. Governors of the USPS*, 485 F.2d 768, 773 (D.C. Cir. 1973)). See also *Direct Marketing Ass’n v. USPS*, 778

F.2d 96, 102, 110-11 (2d Cir. 1985); *MCI Telecom. Corp. v. FCC*, 675 F.2d at 415-16.

The Commission's determination of where to draw the line should be guided by the relevant evidence and argument presented. *United Parcel Service*, 184 F.3d at 841.

Wherever the line is drawn, it will reflect econometric results vastly superior to the totally unproven and unsupported assumption of 100 percent mail processing volume variability.

- C. Given the strong record evidence demonstrating that the variability of allied mail processing operations is less than 100%, the Commission should extend the Postal Service's econometric analysis to allied operations and other similar mail processing cost pools.**

It is unfortunate that the Postal Service was unable to complete econometric analyses for some of the mail processing cost pools, particularly allied operations, which are extremely multidimensional and complex. However, the lack of data with which to establish an independent variability estimate should not lead the Commission to ignore the substantial record evidence demonstrating the less than 100% volume variability for these cost pools as well.

As described by witness Cohen, there are sound operational reasons to extend the econometric estimates of mail processing volume variability to similar cost pools without econometric estimates. Tr. 24/11284-11286. The Commission should adopt these extensions, which combine available econometric and operational information, to produce the best current estimates of the volume variability factors for those cost pools. The only permissible alternative, under the Supreme Court decision in *Greeting Card Publishers* case, would be to treat the costs of those pools as institutional costs rather than attributable costs.

In the case of the allied operations, operational information and preliminary econometric analysis both indicate that volume variability is lower than in the piece distribution operations. Pending a complete econometric analysis of the allied operations, the Commission should adopt witness Cohen's uncontradicted recommendation that the composite volume-variability factor of the distribution operations be used as an upper bound for the volume variability factors of the allied operations. Tr. 24/11286-11287.

V. THE POSTAL SERVICE'S REVENUE REQUIREMENT IS OVERSTATED IN OTHER WAYS, AND THE PERIODICALS MARKUP SHOULD BE MAINTAINED AT A LOW LEVEL

Periodicals Mailers show below that, apart from the cost issues identified above, the Postal Service's revenue requirement is overstated, because it fails to reflect the revenues to be received from the "ride-along" program initiated in February 2000, and includes an excessive contingency allowance. We also show that the Commission should continue to recommend a low markup for Periodicals, as requested by the Postal Service.

A. The Postal Service's Revenue Requirement Should Be Reduced by \$10 Million in the Test Year to Reflect Ride-Along Revenues

In her direct testimony, Cohen showed that the test year revenues for Periodicals should be increased to include the \$10 million that the Postal Service itself estimates will be received from the "ride-along" program approved by the Commission as an experimental service that commenced in February, 2000. Tr. 24/11296. Her unrefuted testimony also suggests that this adjustment is conservative, because, even without taking seasonality and ramp up into account, current ride-along revenues are in line with

the Postal Service's forecast of \$10 million in annual revenue from ride-along pieces.
Tr. 38/17077.

B. The Costs Attributed to Periodicals Should Not Be Increased by a Contingency Factor

Although it is not surprising that the intervenors and OCA have presented a bevy of witnesses challenging the Postal Service's request for nearly \$1.7 billion to account for contingencies, the Postal Service's ineffectual defense of its request is unexpected. The Periodicals Mailers support and have joined in the brief of DMA, *et al.*, which demonstrates that the appropriate contingency for general application is 1% if the Commission relies upon FY 1998 base-year data and .25% if the Commission substitutes the updated, FY 1999 data. However, following a brief analysis of the record in support of system-wide contingencies at these alternative levels, Periodicals Mailers will demonstrate that the Commission should take the fully justified, although unprecedented, step of specifying a separate contingency for the Periodicals class—a contingency of zero.

The primary intervenor witness, Lawrence Buc, presented a comprehensive survey of past Commission decisions on this issue. Tr. 22/9533-39. He concluded, among other things, that the appropriate level of contingency cannot be determined by applying a formula (Tr. 22/9543), a proposition with which no party appears to disagree, but that it must be supported by a thorough analysis of financial factors, including historic variances, inflation estimates and the financial position of the Postal Service (Tr. 22/9605), that shows the contingency to be both reasoned and reasonable. Buc showed that the two substantive pages in the testimony of USPS witness Tayman (T-9)

failed, under these tests, to support the 2.5% contingency allowance requested by the Postal Service.

Rather, Tayman in effect seeks more than \$1.6 billion of ratepayer money for the Postal Service based upon subjective judgment and a list of *known* factors that can adversely affect Postal Service financial performance in the test year. These factors, Buc correctly noted (Tr. 22/9542), are irrelevant for several reasons. First, because they are known (and therefore subject to test-year estimation), their existence says nothing about the size of an appropriate contingency. In addition, to the extent that they have affected past performance, such performance included a \$393 million profit in FY 1999 and dramatic improvement in the Postal Service's equity position in the past few years. To the extent that they represent a threat to future balance sheets, they have been taken into account in the roll forward.

Buc's initial testimony and his original recommendation of a 1% contingency were consistent with the direct testimony of OCA witnesses Burns (Tr. 22/9708-19) and Rosenberg. Tr. 22/8902-33. Rosenberg pointed out that a contingency percentage smaller than has been typical is supported by the loss to the economy and to the Postal Service itself of a contingency that is too large, producing rates that are too high. Tr. 22/9827, 9832-33. This point is driven home by the testimony of Coalition of Religious Press Associations witness Stapert, who predicted that implementation of the proposed rates would drive much Nonprofit Periodicals volume from the mail. Tr. 30/14436. Rosenberg also explained that Deputy Postmaster General Nolan's recent comments reinforce prior assertions by the Postal Service that future rate cycles are almost certainly going to be one year shorter than the historical three-year cycles (Tr. 22/9829),

thus reducing both the risk of falling short of projections and the amount of time that will pass until revenues can be increased in the event that a shortfall occurs.

Following the submission of the Postal Service's updated data, Buc submitted supplemental testimony providing a parallel update to his original contingency testimony. Four factors led him to reduce his recommendation to .25%. Tr. 38/17185-90. First, the Postal Service had increased its estimate of the extent to which future labor contracts would escalate labor costs by shifting from its historical use of the Employment Cost Index (ECI) minus one percent to the ECI without an offsetting downward adjustment in its contingency request. Tr. 38/17186-88. This change adds \$246.6 million to the test-year costs. Tr. 38/17188. Second, the cost reductions incorporated into the later forecasts fall short of the reductions to which the Postmaster General has recently committed. Tr. 38/17188-89.²³ Third, the fact that we are now eight months closer to the test year that begins in only a few weeks reduces the risk of "unknown" adverse events. Tr. 38/17189. Finally, Buc pointed out that even with the adjustments made by USPS witness Patelunas, including new inflation estimates and use of the full ECI, the impact on the Postal Service's bottom line was only .38%, which demonstrates that a contingency of even 1% is excessive. Tr. 38/17189-90.

In response to the direct cases of the OCA and intervenors, the Postal Service offered the rebuttal testimony of witnesses Zarnowitz and Strasser. Zarnowitz premised his lukewarm support for the Postal Service's request on his challenge to the

²³ Rosenberg noted that the Postal Service's reservation of a \$200 million "field reserve" should be considered an increment to its contingency allowance (Tr. 41/18304), as did witness Stapert in response to questions from the bench. Tr. 30/14522-23.

propositions that inflation will continue to be relatively low and that the economy will remain stable. Tr. 41/18188. With testimony that reads more like a pessimist's view of the long term (see Tr. 41/18232) than a contingency witness's analysis of the test year, Zarnowitz admitted (Tr. 41/18260-61) that he had not really focused on FY 2001 and that "I should have gotten more information." Tr. 41/18261. In fact, his testimony supports the notion that a contingency should be reduced as the test year grows closer, confirming that it is easier to forecast one year into the future than two years out and that, as a general principle, the closer one is to the period to which the forecast applies, the better that forecast will be. Tr. 41/18234, 18241.

Strasser's testimony was more comprehensive but no more compelling. He, too, stressed known factors, such as inflation, to support both his conclusion that the test year is riskier than the previous two years (Tr. 46-A/20182) and the 2.5% contingency request. He contended (Tr. 46-A/20183) that this level of contingency reflects "the level of risk that the Postal Service is willing to assume in the test year with regard to unknown developments." Periodicals Mailers submit that the contingency is more accurately described as the level of burden that the Postal Service is willing to place upon mailers, because it is clear that the Postal Service is well-equipped to deal with the possibility of a small loss through either future rate cases or exercise of its borrowing authority.²⁴

²⁴ Under questioning from Commissioner Goldway, witness Bernheimer explained that the Postal Service may well have too little debt and may be routinely burdening its ratepayers unduly through its insistence upon funding capital expenses from current revenues. Tr. 46-A/20461-62.

In addition, cross-examination of Strasser and his responses to questions from the bench confirmed that the \$1.7 billion contingency sought from ratepayers in this case are not dedicated funds held in reserve for future contingencies but are a non-balance sheet construct designed for ratemaking purposes that postal management is free to spend or invest as it sees fit. Tr. 46-A/20405.²⁵ In fact, Strasser had difficulty explaining to Commissioner Goldway exactly how contingency funds are treated. Tr. 46-A/20369-72.

Strasser also admitted that the Postal Service attempts to make its estimates of costs and revenues as accurate as possible (Tr. 46-A/20404); it therefore appears that the likelihood of overestimating Postal Service costs is as great as the likelihood of underestimating them. He agreed that if the contingency request is excessive and raises rates unnecessarily, the result could be loss of customers, which would benefit neither customers nor the Postal Service. Tr. 46-A/20338. Because Periodicals volumes are so predictable, as are the costs incurred in handling and delivering them, the Commission should conclude that Mr. Strasser's testimony supports a much lower contingency factor for Periodicals.

For these reasons and the reasons stated in the brief of DMA, *et al.*, of which we are co-sponsors, the Commission should adopt the recommendations of witness Buc as the appropriate contingency allowance for general application. But its analysis should not end there, for, as William Morrow testified for the Periodicals Mailers, there is no

²⁵ For this reason, the \$475 million test-year "loss" forecast by Mr. Patelunas is really a net income of more than \$1 billion if the Postal Service's cost forecasts (without the contingency) are accurate. Tr. 46-A/20343-45.

reason—other than blind adherence to the past—that would justify a failure to examine whether it is appropriate to apply the same contingency to each postal product.

Tr. 29/13547. Morrow is the executive vice president/operations of Crain Communications, an attorney, a Certified Public Accountant and the former partner in charge of the Detroit region for Touche Ross & Company (now known as Deloitte and Touche). Tr. 29/13544. He testified that, from an accounting standpoint, “it makes far more sense to view a contingency allowance or its functional equivalent on a product-by-product rather than a corporate basis.” Tr. 29/13547.

Morrow explained that in the publishing business, as in any business, the analysis of, for example, new ventures would not assume that the risks of forecast errors are the same for all ventures. Rather, if a contingency for forecast errors were to be built into forecasts, the level of contingency would reflect the differences in risk among the options. Tr. 29/13548. Similarly, he concluded (*id.*), “if there is good reason to believe that the possibility of forecast errors may well be significantly different for different postal products, there is no reason that I know of why the same contingency factor need be applied to every class and subclass of mail.” Postal Service witness Tayman confirmed that he knows of no study supporting the theory that a contingency should be the same across all product lines. Tr. 2/327.

Morrow recognized that his proposal has not been implemented before and that, under normal circumstances, it may well be inefficient for both the Postal Service and this Commission to develop separate contingencies for each subclass. Tr. 29/13549. However, he demonstrated that the unique factual circumstances of this case justify that exercise, at least for this case. (*Id.*).

One such circumstance is the nearly 15% average rate increase faced by most Regular Rate Periodical mailers,²⁶ a rate increase more than twice the system average, and the 20% and higher increase faced by Nonprofit Periodical mailers (Stapert, Tr. 30/14434, 14438). Morrow pointed to PRC Op. R94-1 at II-12-13, in which both Postal Service witness Porras and the Commission itself relied upon the large size of recent rate increases to justify a smaller-than-normal contingency that would constrain the proposed increase. Tr. 29/13549. Periodical mailers, Morrow testified, should not face an excessive contingency merely because other mailers are facing far more moderate increases. Tr. 29/13549-50.

We stress, however, as did Morrow (Tr. 29/13550), that neither “the mere size of the increase [n]or the hardship that it will impose upon [P]eriodical mailers” alone justifies the elimination of a Periodicals contingency. Rather, these factors combine with the unprecedented efforts of the Postal Service and mailers to identify and overcome the causes of the rapid, unexplained Periodicals cost increases of recent years to support elimination of the about \$60 million of contingency included by the Postal Service in Periodicals’ test-year costs. USPS-T-14, Exhibit USPS-14L at 1.

Those efforts began with the work of the Periodicals Operations Review Team, which are described in the testimony of witness James R. O’Brien. Tr. 24/11166-95.

²⁶ Morrow showed that, for his company’s twenty periodicals, ranging in circulation size from 6,000 to 325,000, the average increase at the proposed rates would be 14.76%, with most increases very close to 15%. Tr. 29/13558. He also showed that another ABM member, Cahners Business Information, had calculated an average increase of 14.62% for forty-five publications with circulations ranging from 1,000 to 199,000, again with increases hovering around 15% (Tr. 29/13559). MPA witness Cohen’s data from 127 MPA members reveal an average increase of 14.9%, again with little variation around that average. Tr. 24/11299-301.

The Postmaster General followed that work with repeated pledges to stem the Periodicals cost trend (Tr. 29/13555), and the record here shows that, indeed, a good start has been made at reducing Periodicals costs as early as the test year, as shown previously in this brief. However, the cost reductions to which the Postal Service has agreed, while helpful in reducing the proposed rate increase by at least \$203 million (Tr. 38/17329, 17357-58), are limited in scope and reflect only a portion of the initiatives identified in the Team Report and elsewhere. Periodicals Mailers witnesses Cohen, Nelson and Glick have identified additional cost reductions likely to take place in the test year. Other identified cost reduction efforts not yet susceptible to accurate quantification and others not yet identified²⁷ would, if successful, reduce Periodical costs further, but it is clear that not all of the costs that may be eliminated will be excluded from the Commission approved test-year Periodical costs.

It is appropriate to exclude these savings when there is substantial doubt that the savings will materialize, but only if the possibility that that these cost reduction efforts will succeed is taken into account in the formulation of an appropriate contingency amount *for Periodicals*. The Commission previously has made it clear that favorable, as well as unfavorable, unknowns must be considered. PRC Op. R84-1 at 28.

If the Commission heeds its own words about considering the potential for favorable as well as unfavorable possibilities, it should reach the same conclusion as

²⁷ Periodicals Mailers hope and expect that the mere transmitting of the "Periodicals costs matter" message to the field will have the effect of improving the level of processing costs. Perhaps the resulting efforts of postal workers will permit the Postal Service to reach the productivity and cost-saving goals established by the Postmaster General. In words especially apt here, Chairman Gleiman called the gap between the pledge and the forecast "[k]ind of a reverse contingency." Tr. 35/16811.

Mr. Morrow, who testified that "it is not only appropriate but necessary to offset whatever unknown cost increases contribute to the need for a contingency allowance [for Periodicals] by the more certain cost reductions that will result from these admirable Postal Service efforts [to reduce Periodicals costs]." Tr. 29/17557. The Commission has the authority to do so, as it found in its Recommended Decision in Docket No. R84-1. There, clarifying its authority following the issuance of the decision in *Newsweek, Inc. v. United States Postal Service*, 663 F.2d 1186 (2d Cir. 1981), *aff'd sub nom.*, *National Ass'n of Greeting Card Pubs. v. United States Postal Service*, 462 U.S. 80, the Commission found (at 25):

Accordingly, we have concluded that the Commission has both the authority and the responsibility to make adjustments in the Postal Service's proposed revenue requirement, so long as our adjustments are not arbitrary, our reasoning is fully articulated and based upon substantial evidence in the record, and where our adjustments have neither the intent nor the effect of causing more frequent rate filings nor constitute an intrusion into the policymaking domain of the Board in accordance with the holding in *Newsweek*.
[footnote omitted]

Setting the contingency allowance at zero for Periodicals would meet these tests. Morrow's proposal, which has been presented by an experienced accountant, certainly is not arbitrary and is based upon substantial record evidence that has been neither cross-examined nor rebutted by the Postal Service (or any other party). The adjustment to the revenue requirement that would result from adoption of this proposal depends upon the level of contingency otherwise approved, but because Periodicals contribute

only about 3% of Postal Service revenues, a reduction in Periodicals revenues of 2.5 %, or 1 %, or .25%, would have a *de minimis* effect on Postal Service revenues.²⁸

A revenue effect of this magnitude cannot affect the timing of future rate filings and cannot possibly intrude into the policymaking domain of the Board of Governors. In fact, elimination of the Periodicals contingency would assist the Commission in reaching a single-digit increase for Periodicals, a goal now supported by the Postal Service. Tr. 43/18775-77. Accordingly, the Commission should find that zero contingency for Periodicals, combined with whatever contingency it applies to the other classes, is reasonable under the factual circumstances of, and considering the evidentiary record in, this proceeding.

C. The Cost Coverage for Periodicals Should Be Maintained at a Low Level

In recent cases, the Commission has relied upon several sections of the Postal Reorganization Act to support a low cost coverage for Periodicals, and there is no reason here to depart from that reasoning or that result. Section 101(a) provides that the Postal Service “shall have as its basic function the obligation to provide postal services to bind the nation together through the personal, educational, literary and business correspondence of the people.” Section 101(d) directs the Postal Service to “apportion the costs of postal operations to all users of the mail on a fair and equitable basis,” and section 403(a) directs it to “provide adequate and efficient postal services at fair and reasonable rates.”

²⁸ Even if the Commission were to approve the full 2.5 % contingency allowance requested, elimination of a Periodicals contingency would deprive the Postal Service of only about \$60 million, or less than one tenth of one percent of its revenues.

Particularly relevant to Periodicals mailers are the directives in section 3622(b)(4), which requires consideration of the effect of rate increases upon the general public and business mail users, and in section 3622(b)(8). That section directs the Postal Service to consider the "educational, cultural, scientific and informational value to the recipient of mail matter." In this connection, witness Morrow explains that it will be difficult, at best, for publishers to pass on a cost increase of this magnitude, especially at a time of low inflation and of broader competition for advertising dollars. Tr. 29/13546. He testified that the requested increase would have a significant impact upon publishers' operations and "could stifle the development of new periodical products that will benefit not only Crain but also the Postal Service and the nation's business community." Tr. 29/13547. "Anything that interferes with the normal development of periodicals to serve new or growing businesses," he added, including postage increases out of line with inflation, "can cause damage well beyond the loss to the bottom line of the publisher." *Id.*

Witness Navasky, publisher of *The Nation*, eloquently described the plight of small, independent journals of opinion when faced with postal rate increases of the magnitude proposed here. Tr. 28/13359-63. A number of them, he predicted, could be put out of business. *Id.* at 13363. Stapert confirmed that the proposed increase would drive volumes out of the Postal Service (Tr. 30/14436), and CRPA witness Horton provided a vivid example of a nonprofit publication that "simply cannot absorb another postal increase of this magnitude. . . ." Tr. 30/14349.

The Commission has been given broad discretion in applying the pricing factors of the Act, and it has exercised both that discretion and its concern about the reliability

of Postal Service costing data and methodologies to restrain the Periodicals cost coverage in at least the past three rate cases. See PRC Ops. R90-1, para. 5246; R94-1, para 4055; R97-1, para 5816-17. The Postal Service followed that approach in its rate request and restrained the Periodicals cost coverage. Periodicals Mailers urge the Commission to recommend again a Periodicals cost coverage sufficiently modest to ensure that the average rate increase recommended for Periodicals does not exceed the average increase recommended for all classes.

VI. RATE DESIGN ISSUES

In this case there are still many unknowns. In particular, we do not yet know either the revenue requirement or the cost data upon which the Commission will base its rate design. In this section, we therefore focus on methodological issues affecting Periodicals rate design, including the types of rate elements and the methods used to determine worksharing cost differentials.

We recommend for adoption a new Periodicals rate element, proposed by witness Stralberg (Tr. 24/11405, *et seq.*), that will encourage mailers to create more 5-digit pallets, which avoid a number of costly allied operations normally performed at the destinating SCF. In addition, we recommend the correction of several errors that have been identified by witnesses Stralberg (Tr. 24/11390-99) and Glick (PostCom, *et al.*-T-1 Tr. 32/15722-29) in the mail flow models used by the Postal Service to compute worksharing related cost savings. No party has filed rebuttal or expressed opposition to these rate design proposals.

We also support the proposal, described in a separate NNA brief, that mailers who perform some of the Postal Service's work by taking mail to delivery units in an operation often called "exceptional dispatch" be granted an appropriate discount, commensurate with the costs they help the Postal Service avoid. Tr. 24/11049.

A. The Commission Should Accept Witnesses Stralberg and Glick's Corrections to the Mail Flow Model Used for Rate Design

In USPS-T-25, witness Yacobucci has presented a new flats mail flow model (USPS-LR-I-90) for First Class, Periodicals and Standard (A) flats. The model was meant to provide a more accurate analysis of bundle handling costs, including costs of premature bundle breakage. As shown by Stralberg, Yacobucci's model is deficient in several respects, including:

- (1) reliance on essentially worthless data on bundle breakage frequency rather than on far superior data that was subsequently collected,
- (2) inability to distinguish between mail entered in sacks and on pallets, and
- (3) failure to recognize all of the ways in which bundle breakage leads to extra costs.

Tr. 24/11391, 11394.

Additionally, Glick demonstrates that some flats sorting productivity and accept rates in Yacobucci's model (LR-I-90) are based on a misinterpretation of MODS data and cause an understatement of the cost differential between pre-barcoded and non-barcoded flats. Tr. 32/15721.

Glick and Stralberg jointly developed and presented as an Excel spreadsheet in MPA-LR-2 a greatly improved flats mail flow model for analysis of presort and

automation-related cost differentials.²⁹ The evidence favoring the use of this improved model to determine flats presort and automation related cost avoidances is overwhelming. This model uses far superior and more recent data on bundle breakage. As Stralberg noted, after describing the dismal quality of the essentially anecdotal data relied on by Yacobucci:

Fortunately, the record in this docket contains a far more reliable database on bundle breakage for Periodicals and Standard A flats, based on an MTAC survey last fall of what happens as flat bundles are dumped on SPBS's (small parcel and bundle sorters) and manual sorting belts. MTAC team members counted flats bundles in thousands of Periodicals and Standard A containers, recording extensive information about bundle make-up, breakage rates and other bundle damage.

Tr. 24/11391.

The MTAC bundle integrity data reveal an order-of-magnitude difference in bundle breakage rates for sacked and palletized mail, a fact that the original model in USPS-LR-I-90 simply is not capable of recognizing. Yacobucci himself acknowledged that the MTAC data used in MPA-LR-2 and MPA-LR-14 are the most reliable source of information on bundle breakage. Tr. 5/1508-10.³⁰ The MPA-LR-2 (or alternatively MPA-LR-14) spreadsheet is, therefore, the only model on record in this docket that provides a realistic treatment of the bundle breakage issue and a precise way to estimate the test year impact of major ongoing initiatives by mailers and the Postal Service to reduce

²⁹ The record also contains a model (MPA-LR-14) that corresponds to MPA-LR-2 but uses test year costs rolled forward from FY99. MPA-LR-14 would be the appropriate version to use if the Commission decides to use FY99-based cost data. As Stralberg noted (Tr. 38/17054), if the FY99 based model version is used, the cost-pool and subclass-specific mail processing unit costs used to adjust worksharing costs to test year CRA costs should be replaced by the unit costs provided in USPS LR-I-464. (That library reference was not yet available when Stralberg prepared the spreadsheet in MPA-LR-14.)

³⁰ See also the article on bundle breakage in the July, 2000 issue of "Memo To Mailers." The MTAC bundle integrity team is currently performing a follow-up study, focusing on why bundles in sacks tend to break with such high frequency.

bundle breakage costs. As noted above, using this more precise model, Stralberg and Glick both estimate a test year cost reduction of \$21 million for outside county Periodicals due to reduced bundle breakage.

B. The Commission Should Correct the DDU Discount Proposed by the Postal Service

In his testimony, Stralberg also identified an error in the Postal Service models that estimate the cost avoidance resulting from dropshipping directly to the delivery unit (DDU). The Postal Service models do not take account of the savings that occur because of the requirement that the mailer (*i.e.*, his driver) perform the unloading when mail is entered at the DDU. Postal Service employees would have spent time unloading the mail if it were entered at a destinating SCF or any other facility. Corrected model versions for regular rate and nonprofit Periodicals are included in TW-LR-2. Similar adjustments should be made for Standard (A) DDU dropship savings.

C. The Commission Should Approve the Periodicals Mailers Uncontradicted Proposal for a 5-Digit Pallet Discount

Another feature in Periodicals rate design that we recommend that the Commission adopt is a new rate element, proposed by Stralberg (Tr. 24/11405-09), consisting of a two cent per piece discount for mail that is prepared on 5-digit pallets, conforms with all applicable Postal Service regulations, and is entered at the destinating SCF or delivery unit. Preparing mail on 5-digit pallets often means creating more, smaller pallets and tends to add to the costs incurred by printers and passed on to mailers. On the other hand, the cost savings realized by the Postal Service can be substantial, as evidenced by the almost universal desire for more 5-digit pallets expressed by Postal Service facility managers. Tr. 24/11405. Because relatively little

mail is entered on 5-digit pallets today, creating such a discount will have minimal impact on rates for other mail in the subclass. Moreover, the discount proposed reflects only avoided bundle handling costs at the SCF. Because 5-digit pallets avoid other costs as well, the net effect of the discount will be to benefit all Periodicals as additional mail is tenders at destinating SCFs and DDU's on 5-digit pallets. We urge the Commission to approve this modest improvement in Periodicals rate design, which no participant has opposed or offered to rebut.³¹

D. Automation Savings are larger than Estimated by the Postal Service, and Greater than 100% Passthrough of Savings is Appropriate

We urge the Commission to approve the greater than 100 percent passthroughs of automation-related cost avoidances proposed by witness Taufique (USPS-T-38).

First, as shown by PostCom witnesses Glick and Lubenow, the Postal Service's model (even as corrected by witnesses Glick and Stralberg) ignores a large portion of the savings that result from the higher address quality of automation mail. Tr. 24/11297, citing Tr. 32/15730-31. For this reason, automation cost avoidances are understated. Second, as noted by witness Taufique, it would be inappropriate to change pricing signals, upon which the mailer community makes substantial investments, overnight. This is especially true in the rapidly evolving flats processing environment in which the barcode's value could increase significantly with the deployment of AFSM 100s. Tr. 17/7037-38.

³¹ While savings produced by 5-digit pallets are likely to also have a weight related component, Stralberg chose to propose a discount only in the piece rates, thereby keeping the number of required new rate elements to one. Significantly more than half of Periodicals mail processing costs have traditionally been

VII. CONCLUSION

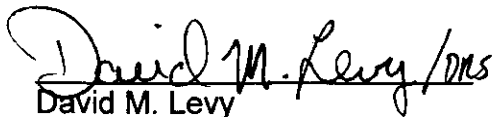
The periodicals industry plays a special role in American life. Since colonial days, its newspapers and magazines have brought to their millions of readers fiction and factual matter of every type, nature and description needed to enable members of society to cope with the "exigencies" of their period. *Thornhill v. Alabama*, 310 U.S. 88, 101-02 (1940). And throughout this history, periodicals publishers from Benjamin Franklin, the first Postmaster General, to Docket R2000-1 witness Victor Navasky (Tr. 28/13357-59) have heeded the special responsibilities that attach to periodicals' unique role as surrogates of the public in locations from courtrooms to factories to foreign battlefields. Periodicals bring the world to our country's work places and living rooms and, as a result, have extraordinary value to their recipients. See 38 U.S.C. §§ 3622(b)(2) and (b)(8).

Given this value, it was particularly inappropriate for the United States Postal Service to have sought from the periodicals industry a devastating rate increase that, as we stated at the start of this brief, is excessive by any measure. While Periodicals Mailers are gratified that the Postal Service has been willing since the filing to suggest, recognize and agree to some of the ways in which the proposed increase should be reduced, we show throughout this brief that it has not gone far enough. We are hopeful that this brief provides the Postal Rate Commission with both the will and the means to

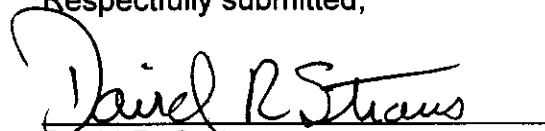
treated as piece-related. If this proposal is adopted, future discounts could incorporate both a piece and a pound component.

recommend a percentage increase for Periodicals that is no greater than the overall percentage increase recommended for the Postal Service.

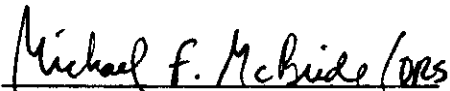
Respectfully submitted,

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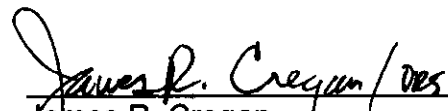
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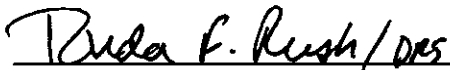
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September 13, 2000

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the following document upon all participants in this proceeding in accordance with section 12 of the Rules of Practice.

David R. Stratus
David R. Stratus